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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1948

No. 151

NATIONAL CARBIDE CORPORATION, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 152

AIR REDUCTION SALES COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

No. 153

PURE CARBONIC, INC., PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 14, 1948.

CERTIORARI GRANTED OCTOBER 11, 1948.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 151

NATIONAL CARBIDE CORPORATION, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

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ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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[fol. 1]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

NATIONAL CARBIDE CORPORATION, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

AIR REDUCTION SALES COMPANY, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner

v.

PURE CARBONIC, INC., Respondent

On Petition for Review of the Decisions of the Tax Court of the United States

STATEMENT UNDER RULE 15 (b)

This proceeding was commenced by the filing of petitions in the Tax Court of the United States on August 16, 1944, by National Carbide Corporation, Air Reduction Sales Co., and Pure Carbonic, Inc. The petitions sought redeterminations of deficiencies in income and declared value excess-profits taxes for the taxable years ended December 31, 1938, which had been determined by the Commissioner of Internal Revenue by notices mailed on May 19, 1944. The Commissioner's answers to the petitions were filed with the Tax Court on September 9, 1944. Hearing was held before Judge Black, a judge of the Tax Court of the United States on November [fol. 2] 13, 1945. No question was referred to a commissioner, master, or referee. The decisions of the Tax Court were entered on March 26, 1947, and it was determined that there were no deficiencies in income or declared value excess-profits taxes with respect to each of the taxpayers. The Commissioner's petitions for review by this Court were filed on June 13, 1947. There has been no change in parties. This Court, by an order dated September 3, 1947, ordered that the cases be consolidated for record, briefing, hearing and decision.

2

IN THE TAX COURT OF THE UNITED STATES

DOCKET ENTRIES

Docket No. 5822

[Caption omitted]

1944

Aug. 16. Petition received and filed. Taxpayer notified. Fee paid.

Aug. 17. Copy of petition served on General Counsel.

Sept. 9. Answer filed by General Counsel.

Sept. 9. Request for Circuit hearing in New York filed by General Counsel.

Sept. 12. Notice issued placing proceeding on New York calendar. Service of answer and request made.

1945

Feb. 16. Hearing set April 9, 1945—New York City.

Mar. 14. Motion for a continuance to a date not earlier than June 1945 filed by taxpayer.

Mar. 21. Hearing had before Judge Murdock on motion of petitioner for a continuance to Fall Calendar—New York City. Granted. City. Appearance of Willard M. L. Robinson filed.

Mar. 21. Motion of March 14, 1945 granted to Fall Calendar, New York.

Aug. 11. Hearing set Sept. 17, 1945 at New York City.

Aug. 17. Motion for one month's continuance filed by taxpayer. 8/20/45 granted to 10/22/45 at New York City.

Aug. 27. Hearing set Oct. 22, 1945—New York City.

Oct. 2. Motion for three weeks continuance filed by taxpayer. 10/10/45 granted to 11/13/45—New York City.

Oct. 8. Hearing set 10/10/45 on petitioner's motion—Washington, D. C.

Oct. 8. Copy of motion and notice of hearing served on General Counsel.

Oct. 10. Hearing had before Judge Turner on motion of petitioner for a continuance—granted. Continued to Nov. 13, 1945 at New York City. Appearance of Willard M. L. Robinson filed.

Oct. 12. Hearing set 11/13/45 at New York City.

Oct. 16. Transcript of hearing of Oct. 10, 1945 filed.

Docket No. 5822

Nov. 13, 14, 15. Hearing had before Judge Black. On oral motion of petitioner to consolidate dockets 5822, 5823, & 5824 for hearing (respondent agreed)—motion granted. Petitioner's brief due February 1, 1946—respondent's March 15, 1946—petitioner's reply April 5, 1946.

1945

[fol. 3] Nov. 20. Transcript of hearing of Nov. 13, 1945 filed.

Nov. 20. Transcript of hearing of Nov. 14, 1945 filed.

Nov. 20. Transcript of hearing of Nov. 15, 1945 filed.

1946

Jan. 18. Motion for extension to Feb. 21, 1946 to file petitioner's brief—April 5, 1946 to file respondent's brief and April 26, 1946 to file reply brief by taxpayer. 1/18/46 granted.

Feb. 21. Brief filed by taxpayer. 2/25/46 copy served.

Apr. 1. Motion for extension to April 20, 1946 to file respondent's brief and May 11, 1946 to file petitioner's reply brief filed by General Counsel. 4/2/46 granted.

Apr. 19. Motion for extension to April 30, 1946 to file respondent's brief and to May 21, 1946 to file petitioner's reply brief filed by General Counsel. 4/23/46 granted.

May 3. Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 5/6/46 granted.

May 20. Motion for extension to June 10, 1946 to file reply brief, filed by taxpayer. 5/21/46 granted.

June 17. Motion for leave to file the attached reply brief filed by taxpayer. 6/17/46 granted.

June 17. Reply brief filed by taxpayer. 6/17/46 copy served.

1947

Mar. 25. Findings of fact and opinion rendered, Black J. Decision will be entered for the petitioner. 3/26/47 copy served.

Mar. 26. Decision entered, Black J. Div. 15.

June 13. Petition for review by U. S. Circuit Court of Appeals, 2nd Circuit, with assignments of error filed by General Counsel.

June 13. Notice of filing petition for review on Winfield A. Huppuch, 2nd, Esq., filed.

June 19. Proof of service filed.

July 15. Motion for extension to September 11, 1947, to prepare and transmit record filed by General Counsel.

July 15. Order extending time to Sept. 11, 1947 to prepare and transmit record entered.

Sept. 4. Certified copy of an order from 2nd Circuit extending time to October 8, 1947 to prepare and transmit record filed.

Sept. 4. Certified copy of order from 2nd Circuit consolidating dockets 5822, 5823 & 5824 with complete record only in docket 5822 and abbreviated records in dockets 5823 & 5824 all under one cover. Further ordered that all exhibits be transmitted to Court in original form upon advice of counsel 10 days before trial and that copy of this order be incorporated in transcript of record on review filed.

Sept. 8. Designation of contents of record on review filed by General Counsel with proof of service thereon.

[The docket entries in Docket No. 5823 (Tr. 465-466) and in Docket No. 5824 (Tr. 493-494) are identical with those in Docket No. 5822.]

[fol. 4] IN THE TAX COURT OF THE UNITED STATES

DECISION

Docket No. 5822

(Tr. 50.)

[Caption omitted]

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 25, 1947, it is ordered and decided: That there are no deficiencies in income tax and declared value excess profits tax for the calendar year 1938.

(Signed) Eugene Black, Judge.

Entered Mar. 26, 1947.

Received Apr. 2, 1947. Counsel, New York Division, New York City Office.

IN THE TAX COURT OF THE UNITED STATES

DECISION

Docket No. 5823

(Tr. 479.)

[Caption omitted]

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 25, 1947, it is ordered and decided: That there are no deficiencies in income tax and declared value excess-profits tax for the calendar year 1938.

(Signed) Eugene Black, Judge.

Entered Mar. 26, 1947.
Received Apr. 2, 1947. Counsel, New York Division, New York City Office.

IN THE TAX COURT OF THE UNITED STATES

DECISION

Docket No. 5824

(Tr. 511.)

[Caption omitted]

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion, promulgated March 25, 1947, it is ordered and decided: That there are no deficien-
[fol. 5] cies in income tax and declared value excess-profits tax for the calendar year 1938.

(Signed) Eugene Black, Judge.

Entered Mar. 26, 1947.
Received Apr. 2, 1947. Counsel, New York Division, New York City Office.

IN THE TAX COURT OF THE UNITED STATES

Findings of Fact and Opinion

Docket Nos. 5822, 5823 and 5824

(Tr. 14-19.)

[Caption omitted.]

These proceedings, consolidated for hearing, involve deficiencies in income tax and declared value excess-profits tax for the taxable year ended December 31, 1938, in amounts as follows:

Petitioner	Docket Number	Income tax	Declared value excess-profits tax
National Carbide Corp.	5822	$122,285.56	$101,019.08
Air Reduction Sales Co.	5823	439,347.98	364,076.24
Pure Carbonic, Inc.	5824	21,663.71	17,860.53

The deficiencies in Docket Nos. 5822 and 5823 are due to adjustments to net income as follows:

	Docket No. 5822	Docket No. 5823
Net income as disclosed by return	$300.00	$750.00
Unallowable deductions and additional income:		
(a) Additional income	881,244.30	3,314,141.10
Total	881,544.30	3,314,891.10
Nontaxable income and additional deductions:		
(b) Capital stock tax	4.00	8.00
(c) Expenses of Air Reduction Co., Inc.	39,214.78	279,914.57
Net income adjusted	842,325.52	3,034,968.53

[fol. 6] In Docket No. 5822, the respondent, in a statement attached to the deficiency notice, explained adjustments (a) and (c) as follows:

> (a) and (c) All of your capital stock is owned by Air Reduction Company, Inc., and, on your return, all of your net income in excess of $300.00 was deducted

and allocated to the parent company on the theory that you were an agent for said company. It is held that as a corporate entity, operating as such, you are taxable on your separate income. Such expenses as were paid or accrued by Air Reduction Company, Inc., attributable to your operations have been allocated to you under section 45 of the Revenue Act of 1938.

In Docket No. 5823, the respondent made an identical explanation of adjustments (a) and (c) except that he mentioned therein $750 instead of $300.

The deficiencies in Docket No. 5824 are due to adjustments to net income as follows:

Net income as disclosed by return	$300.00
Unallowable deductions and additional income:	
(a) Additional income	157,595.25
(b) Amortization of Contract Rights	23,137.02
(c) Legal fees	46,291.50
Total	227,323.77
Nontaxable income and additional deductions:	
(d) Capital stock tax	4.00
(e) Expenses of Air Reduction Co., Inc.	77,982.18
Net income adjusted	149,337.59

In Docket No. 5824, the respondent, in a statement attached to the deficiency notice, explained adjustments (a) and (e) in the same manner as he explained (a) and (c) in Docket No. 5822. He also explained adjustments (b) and (c), respectively, as follows:

> (b) This adjustment corresponds with that made in the amended return filed by you and is detailed in the copy of the report furnished you.
>
> (c) The payment of $35,000.00 plus legal fees of $11,291.50 or a total of $46,291.50 in connection with [fol. 7] the acquisition of 100 shares of capital stock of Braunstein Bros. Carbonic Sales Corporation constitutes a capital expenditure not deductible from income.

Petitioners by appropriate assignments of error, contest all of the above-mentioned adjustments in all three docket

numbers except the three small capital stock tax adjustments.

Findings of Fact

Each of the three petitioners is a Delaware corporation with its principal office at 60 East 42nd Street, New York, N. Y. The return of each petitioner for the taxable year ended December 31, 1938, was filed with the collector for the third district of New York.

All of the capital stock of each petitioner is, and during the taxable year and prior thereto was, owned by Airco Reduction Company, Incorporated, a New York corporation. This latter corporation is sometimes referred to herein as "Airco". Petitioners are sometime referred to herein respectively as "Carbide", "Sales" and "Carbonic". Airco also owned all of the capital stock of Wilson Welder & Metals Co., Inc., sometimes referred to herein as "Welder". These five corporations are sometimes referred to herein as "all the companies".

In 1938 Airco was engaged in four major fields of business activity and employed the agency companies in each field as follows:

Air Reduction Sales Company. The manufacture and sale of: gaseous constituents of air, principally oxygen and nitrogen, but also the rare gases, argon, neon, zenon, krypton and helium; acetylene produced by the action of water on calcium carbide and used together with oxygen in the ox-acetylene gas welding and cutting processes; hydrogen produced by the electrolysis of water and used in annealing and welding metals; tools and apparatus for the utilization of these gases and containers for the transportation of acetylene gas.

National Carbide Corporation. The manufacture and sale of: calcium carbide obtained by fusing limestone and coke in an electric furnace, and used by Airco to supply its own [fol. 8] requirements for making acetylene gas and, in part, for sale to customers for the manufacture of acetylene.

Pure Carbonic, Incorporated. The manufacture and sale of: carbon dioxide in gaseous and liquid form ("carbonic acid gas") and in solid form ("dry ice"); and apparatus for their utilization and transportation. In liquid and gaseous form carbon dioxide is used primarily in the car-

bonation of beverages and in solid form as dry ice for refrigeration.

Wilson Welder & Metals Co., Inc. (Not a petitioner herein.) The manufacture, assembly and sale of electric arc welding machines, welding rods, equipment and supplies.

Carbide on page 1 of its return (Form 1120A) for the taxable year reported $300 as its gross and net income, respectively, with the notation "See Schedule 'Q' Attached." This schedule, among other things, stated:

National Carbide Corporation

The following is a statement of agency operations of National Carbide Corporation for the year ended December 31, 1938.

National Carbide Corporation, whose entire outstanding capital stock (nominal in amount) is owned by Air Reduction Company, Incorporated, operates exclusively under an agency agreement in the conduct of the business and the holding of certain assets as nominee of Air Reduction Company, Incorporated. This agreement was originated on or about the date of incorporation. For this service the nominee receives $300.00 per annum, representing 6% on its outstanding capital stock. Accordingly, the results of this agency operation are included in the tax return of Air Reduction Company, Incorporated. A copy of the operating agreement aforementioned was filed with the U. S. Treasury Department Internal Revenue Service as a part of the Federal Income and Excess-Profits Tax return for the year ended December 31, 1934.

[fol. 9] Gross Income

[Here Carbide itemizes several items of gross income, totalling $1,430,523.76.]

Total Income $1,430,523.76

Deductions	
[Here Carbide itemizes several items of deduction such as compensation of officers, rent, repairs, bad debts, taxes, depreciation, selling expense, distribution expense, administration expense, etc., totalling $548,979.46.]	
Total Deductions	548,979.46
Book and Taxable Net Income before estimated Federal income tax	881,544.30
Estimated Federal income tax	167,455.92
Net income after estimated Federal income tax	714,088.38
Amount transferred to Air Reduction Company, Incorporated in accordance with agency agreement above	713,788.38
Net amount retained per agreement	300.00

Sales on page 1 of its return (Form 1120A) for the taxable year reported $750 as its gross and net income, respectively, with the notation "See Schedule 'Q' attached." This schedule follows the same pattern as the one filed by Carbide and, after itemizing the gross income and deductions, concludes as follows:

Taxable net income	$3,314,891.10
Amount necessary to reconcile with book income	18,535.10
Net book income before estimated Federal income tax	3,333,426.20
Estimated Federal income tax	631,339.84
Net book income after estimated Federal income tax	2,702,086.36
Amount transferred to Air Reduction Company, Incorporated, in accordance with agreement above	2,701,336.36
Net amount retained per agreement	750.00

Carbonic on page 1 of its return (Form 1120A) for the taxable year reported $300 as its gross and net income, re- [fol. 10] spectively, with the notation "See Schedule 'Q' attached." This schedule follows the same pattern as the ones filed by Carbide and Sales and, after itemizing the gross income and deductions, concludes as follows:

Taxable net income	$157,895.25
Amount necessary to reconcile with book income	91,131.23
Net income per books before estimated Federal income tax	249,026.48
Estimated Federal income tax	30,039.43
Net income per books after estimated Federal income tax	218,987.05
Amount transferred to Air Reduction Company, Incorporated in accordance with agency agreement above	218,687.05
Net amount retained per agreement	300.00

The three above-mentioned schedules were also attached to the return (Form 1120) filed by Airco for the calendar year 1938. Attached to the return filed by Airco was also a schedule relating to the operations of Welder which followed the same pattern as the three above-mentioned schedules and which, after itemizing the gross income and deductions, concluded as follows (Note: Amounts in parenthesis are in red ink):

Taxable net income (Loss)	($88,432.07)
Amount necessary to reconcile with back income	(1,908.67)
Net income per books (Loss)	(90,340.74)
Amount transferred to Air Reduction Company, Incorporated in accordance with agreement above	(90,940.74)
Amount retained per agreement	600.00

Airco on page 1 of its return for the calendar year 1938 reported a gross income of $15,153,603.71, deductions of

$10,942,640.43, a net income of $4,210,963.28, an income tax due of $639,397.91, and an excess-profits tax due of "None." It later filed an amended return for this year in which it reduced the deductions by an amount of $23,137.02 (see adjustment (b) in statement attached to deficiency notice sent to Carbonic) thereby increasing the net income by a like amount and showing an additional income tax due of $3,847.61.

[fol. 11] Airco was incorporated on November 26, 1915; Sales on June 27, 1916; Carbide on July 28, 1922; and Carbonic on September 23, 1929.

In 1938 Airco had outstanding 2,579,855⅕ shares of capital stock; Carbide 50 shares of $100 par value; Sales 125 shares of $100 par value; Carbonic 50 shares of $100 par value; and Welder 100 shares of no par value. Not any of these corporations had any funded debt.

The above-mentioned returns filed for the calendar year 1938 required the particular taxpayer to state the "Value of capital stock as declared in your capital stock tax return for the year ended June 30, 1938 * * *." Airco reported this value to be $72,981,000; Carbide reported $3,999; Sales reported $7,999; and Carbonic reported $3,999. (Note: 10 percent of these reported values was in excess of the net income as reported by petitioners and Airco on page 1 of their respective returns; hence no excess-profits tax was reported as due. See sections 601 and 602 of the Revenue Act of 1938.)

Airco was organized primarily for the purpose of producing oxygen from the air for use with acetylene in the oxyacetylene process. In producing oxygen the air is liquefied under pressure and then at different sub-zero temperatures nitrogen as well as oxygen is distilled and also such rare gases as argon, neon, zeon, krypton and helium. These rare gases comprise less than 1 percent of the total of air. Disregarding the rare gases, oxygen comprises about 1/5 of the atmosphere and nitrogen about 4/5. The rare gases are used principally in fluorescent lighting.

From the time Airco was organized in 1915 through 1919, it organized or acquired 15 subsidiary companies for the manufacture and distribution of gases. These plants were spread throughout the several states. Airco paid the bills for the organization of those companies which it organized, and paid cash or issued stock for the

companies that were acquired. In the companies that were organized Airco paid in the capital and took the stock.

When Sales was organized in 1916, Airco initiated a policy in connection with that company and the 15 subsidiaries. [fol. 12] That policy was the signing of an agency agreement early in 1917 between Airco and Sales and a similar agreement between each new company organized or acquired and Sales. The said agency agreement between Airco and Sales was made on March 1, 1917, and among other things provided as follows:

> That for good and valuable considerations each to the other given and received, the parties hereto hereby agree as follows:
>
> First.—Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases, which it or its subsidiary or controlled companies now own or control, or which it or they may hereafter build or acquire; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants.
>
> Second.—This contract, and the said employment of Sales hereunder, shall continue until December 31st, 1917; and thereafter shall continue from year to year subject to the right of either party to terminate the same at any time by giving thirty days previous written notice to the other of its intention so to do.
>
> Third.—Airco agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment, and shipping facilities, which it now owns or may hereafter acquire; (2) to supply such working capital as Sales may need; (3) to provide such executive management (but not accounting, bookkeeping and clerical service), and office accommodation and facilities, as may be necessary for the proper conduct of Sales business; and (4) to procure for Sales such contracts with Airco's subsidiary or controlled companies as will enable Sales to exercise in each case the agency hereby created, and as will in each case constitute Sales the agent of such subsidiary or controlled company.

Fourth.—Sales agrees (1) to manage and operate efficiently and carefully all of said plants; (2) to main- [fol. 13] tain the same in first class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation and for wear and tear not immediately replaceable by repairs; (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible, realizing, to the best of its ability, the largest obtainable gross receipts therefrom; (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (5) to credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six per cent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Airco upon demand any profits becoming due and credited to Airco as aforesaid.

After Sales had been organized the physical assets of the 15 subsidiaries were, at the direction of Airco, turned over to Sales. About 7 of the 15 subsidiaries were dissolved during the period 1923 to 1935 and about May 1936 the remainder of the 15 subsidiaries were dissolved. These dissolutions were made upon Airco's instructions.

During the period 1922 to 1936, Airco purchased the business and assets of 26 other companies and paid either stock or cash or both stock and cash for such assets. These assets were turned over to Sales in order to enable it to function under its agency agreement of 1917.

Airco in order to make its own acetylene had to have calcium carbide so in 1920 it acquired an interest in the National Carbide Corporation of Virginia. About April 1921, it secured control of that company. This company had been operating two plants of its own, one at Ivanhoe, Virginia, and one at Keokuk, Iowa. Calcium carbide is [fol. 14] made by fusing coke and limestone in an electric

furnace; and is turned into acetylene by the action of water on the calcium carbide.

On July 28, 1922, National Carbide Corporation of Virginia organized under the laws of Delaware as a wholly owned subsidiary the National Carbide Sales Corporation.

On August 25, 1922, an agreement was made between National Carbide Corporation of Virginia, therein called the "Company" and National Carbide Sales Corporation, therein called "Sales." (Note: Not to be confused with the petitioner Sales. As will appear later, National Carbide Sales Corporation is the petitioner Carbide; the name National Carbide Sales Corporation being changed to National Carbide Corporation on August 1, 1936.) This agreement states that the parties agree as follows:

> First.—The Company hereby employs Sales as its selling agent to market and sell during the term of this contract, the output of all the plants of the Company.
>
> Second.—The Company agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment and shipping facilities, which it now owns or may hereafter acquire; and (2) to supply such working capital as Sales may need, and (3) to substitute Sales for itself in such contracts as it may heretofore have made with customers for the sale or distribution of its products.
>
> Third.—Sales agrees (1) to distribute, market and sell the product manufactured in said plants as efficiently as possible, realizing, to the best of its ability, the largest obtainable gross receipts therefrom; (2) to collect all accounts receivable or other proceeds resulting therefrom; (3) to credit monthly on its books to the Company all the proceeds from the sale and distribution of the product of such plants over and above the actual overhead and running expenses of its organization and an amount equal to six per cent (6%) per annum on its outstanding capital stock, which amounts it is hereby authorized to deduct and retain, and it hereby agrees to accept the same as full com- [fol. 15] pensation for its services hereunder; and (4) to pay over to the Company upon demand any proceeds becoming due and credited to the Company as aforesaid.

Fourth.—This contract and the said employment of sales hereunder shall continue until August 1st, 1923, and thereafter shall continue from year to year subject to the right of either party to terminate the same at any time by giving thirty (30) days previous written notice to the other of its intention so to do.

On July 31, 1936, Airco caused National Carbide Corporation of Virginia to be liquidated and dissolved. It caused all the assets of that company (with certain exceptions hereinafter mentioned) to be transferred to National Carbide Sales Corporation, subject to all the liabilities of National Carbide Corporation of Virginia, except liabilities for Federal taxes as appearing on its balance sheet as of the close of business July 31, 1936. The excepted assets were license agreements, patents and applications for patents, drawings and formulae, retirement and pension funds, cash, securities, notes and accounts receivable, and books and records. These excepted assets were by bill of sale transferred to Airco, subject however to the liabilities of National Carbide Corporation of Virginia for the Federal taxes above mentioned, which liabilities Airco assumed.

On August 1, 1936, the name of National Carbide Sales Corporation was duly changed to National Carbide Corporation.

On August 1, 1936, an agreement was made between Airco and Carbide. This agreement, after referring to the above-mentioned agreement dated August 25, 1922, recites that the National Carbide Corporation of Virginia has been liquidated "and in pursuance thereof all of its rights and obligations" under said agreement have passed to Airco as its sole stockholder; and that the parties hereto desire to extend the scope of the employment of Carbide under said agreement to provide that Carbide "shall manage and operate said plants in addition to marketing and selling the output thereof * * *." After these recitations the agreement states that the parties agree as follows (Note: In this agreement Airco was referred [fol. 16] to as "Company" and Carbide was referred to as "Sales" which again should not be confused with petitioner Sales):

First.—This Agreement shall be supplementary to the aforesaid Agreement dated August 25, 1922.

Second.—The Company hereby employs Sales as its agent, during the term of this contract, to manage and operate its plants.

Third.—Sales agrees (1) to manage and operate efficiently and carefully said plants; (2) to maintain the same in first class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation and for wear and tear not immediately replaceable by repairs; (3) to pay all expenses of such operation and maintenance and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (4) to credit monthly on its books to the Company all profits accruing to it from the operation of its entire business, over and above an amount equal to six percent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (5) to pay over to the Company upon demand any profits becoming due and credited to the Company as aforesaid.

Fourth.—The provisions contained in subsections (4) and (5) of the foregoing paragraph numbered Third of this Agreement shall be in lieu of subsections (3) and (4) of paragraph numbered Third of the said Agreement dated August 25, 1922, which required Sales to credit to the Company certain proceeds from its selling operations as therein provided, and in all other respects the terms of the said Agreement dated August 25, 1922 shall remain in full force and effect and binding upon the parties hereto.

In 1921, Airco entered the field of manufacturing and distributing carbon dioxide. Carbon dioxide comes in [fol. 17] gaseous, liquid and solid forms. In the gaseous and liquid forms it is commonly known as carbonic acid gas or carbonic gas and in solid form it is known as dry ice. The primary use of carbonic gas is in the carbonation of beverages for human consumption.

In manufacturing carbon dioxide drawn steel cylinders are also used. The carbon dioxide cylinder is practically

the same as an oxygen cylinder, but not the same as an acetylene cylinder. A so-called 220-foot oxygen cylinder weighs empty about 130 pounds and when filled contains about 220 cubic feet of compressed oxygen weighing about 18 pounds. The value of the cylinder itself is about $15 or $16, and the maximum value of the contents is about $2.00. Airco maintained a large distribution department and a large fleet of trucks.

The initial step which Airco took on entering the carbon dioxide field was the acquisition in 1921 of a controlling interest in a concern known as the Compressed Carbonic Company which operated in Baltimore. About 1929 this company either merged or consolidated with Pure Carbonic Company of Illinois and Pure Carbonic Company of California to form Pure Carbonic Company of America. About a month later, namely, on September 23, 1929, Pure Carbonic Company of America organized as its 100 percent owned subsidiary the petitioner referred to herein as Carbonic.

On October 1, 1929, an agreement was made between Pure Carbonic Company of America, therein called "Pure" and Carbonic, therein called "Sales" (Note: Not to be confused with petitioner Sales or the corporations involved in the above-mentioned agreements dated August 25, 1922 and August 1, 1936). The agreement, among other things, provided as follows:

> That for good and valuable consideration each to the other given and received the parties hereto hereby agree as follows:
>
> First.—Pure hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of carbonic acid gas and any and all other gases in gaseous, liquid and solid forms, and all by-products thereof, and for the manufac- [fol. 18] ture of apparatus and containers *of* the utilization and transportation of such gases, which it or its subsidiary or controlled companies now own or control, or which it or they may hereafter build or acquire; and likewise employs Sales *a*t its agent to market and sell, during the term of this contract, the output of all such plants.
>
> Second.—This contract, and the said employment of Sales hereunder, shall continue until October 1st, 1950;

and thereafter shall continue from year to year subject to the right of either party to terminate the same at any time by giving thirty days previous written notice to the other of its intention so to do.

Third.—Pure agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment, and shipping facilities, which it now owns or may hereafter acquire; (2) to supply such working capital as Sales may need; (3) to provide such executive management (but not accounting, bookkeeping and clerical service), and office accommodation and facilities, as may be necessary for the proper conduct of Sales business; and (4) to procure for Sales such contracts with Pure's subsidiary or controlled companies as will enable Sales to exercise in each case the agency hereby created, and as will in each case constitute Sales the agent of such subsidiary or controlled company.

Fourth.—Sales agrees (1) to manage and operate efficiently and carefully all of said plants; (2) to maintain the same in first class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation and for wear and tear not immediately replaceable by repairs; (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible, realizing, to the best of its ability, the largest obtainable gross receipts therefrom; (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; [fol. 19] (5) to credit monthly on its books to Pure all profits accruing to it from the operation of its entire business over and above an amount equal to six per cent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Pure under demand any profits becoming due and credited to Pure as aforesaid.

This agreement shall be binding upon and inure to the benefit of the respective successors and assigns of the parties hereto.

Thereafter, Pure Carbonic Company of America acquired the businesses and assets of three or four other companies. In these acquisitions Airco put up the necessary consideration, and caused the acquired assets to be transferred to Carbonic. On April 6, 1934, Pure Carbonic Company of America purchased the business and assets of American Dry Ice Corporation, and caused the property of that company to be transferred to Dry Ice, Inc., a Delaware corporation organized in 1934 as a wholly owned subsidiary of Pure Carbonic Company of America. Subsequently, Airco acquired the entire capital stock of Pure Carbonic Company of America and dissolved that company on July 30, 1936. Upon this dissolution Airco acquired all of the capital stock of Dry Ice, Inc., that was organized in 1934, and all of the capital stock of Carbonic, including the rights of Pure Carbonic Company of America under the above-mentioned agreement dated October 1, 1929, and directed that all the physical assets of Pure Carbonic Company of America be transferred to Carbonic.

On July 31, 1936, Airco caused the assets of Dry Ice, Inc. (the corporation that was organized in 1934) to be transferred in part to itself and in part to Dry Ice, Inc. (a Delaware corporation organized in 1936) whereupon the 1934 corporation was dissolved. On September 30, 1937, Airco caused the assets of the 1936 corporation (Dry Ice, Inc.) to be transferred in part to itself and in part to Carbonic, whereupon the 1936 corporation was dissolved.

[fol. 20] On May 18, 1938, Airco entered into an agreement with Alabama Carbon Dioxide Ice, Inc. whereby the latter was to transfer to Carbonic all of its assets except furniture, fixtures, cash and accounts receivable. A bill of sale was executed to that effect on March 24, 1938.

On or about January 1, 1931, Airco acquired an interest in Welder. This company was engaged in electric welding as distinguished from gas flame welding. Sometime in 1934, Airco acquired all the outstanding capital stock of that company and about June 1936 it caused the capital stock of that company to be reduced by some $300,000 to $10,000 and also caused the number of shares to be reduced from 10,000 to 100 shares through a partial liquidation. The assets so distributed in partial liquidation went to Airco.

On August 1, 1936, an agreement was made between Airco and Welder similar in its provisions to the above-mentioned

agreements dated March 1, 1917, August 25, 1922, August 1, 1936 and October 1, 1929.

In 1938 Airco and its four subsidiaries were therefore engaged in four fields of operation. The first field was centered around the oxyacetylene process and the business was carried on by Sales. The second field was the calcium carbide business. This consisted of the operation of the plants at Ivanhoe and Keokuk and was carried on by Carbide. The third field was the manufacturing and distribution of carbon dioxide both in the liquid and solid form. The business in this field was carried on by Carbonic. The fourth field was the manufacture and distribution of apparatus and equipment and was carried on by Welder. The products manufactured by these corporations are sometimes familiarly referred to as Airco products. They have 159 plants scattered throughout the United States. The general offices of Airco and its four subsidiaries are located in the Lincoln Building at 60 East 42nd Street, New York City.

Each operating or agency contract has remained in force and unchanged in its terms from its inception down to the present time. After Airco entered into each agreement the initial working capital of the subsidiary was supplied by Airco, and, as time went on, each subsidiary built up additional working capital through its operations which was not [fol. 21] withdrawn by Airco but was left in the subsidiary's bank accounts to maintain minimum working balances based upon the operational requirements of each field of operation.

Title to all gas cylinders, one of the most essential and most valuable assets, was retained by Airco and cylinders were allocated to the various agency companies as required.

The petitioners and Welder acquired assets in addition to those transferred to them directly by Airco or transferred by third parties to them at Airco's direction. They acquired such additional assets upon specific authorization and appropriation by the Airco board of directors, either by payment of cash from working capital directly supplied by Airco, or by payment of cash resulting from the operations of each company under its agency agreement and credited to Airco but not withdrawn by Airco.

There were credited to the accounts payable by the agency companies to Airco and debited to the accounts receivable by Airco from each agency company: the amount of working capital furnished by Airco, the value of all assets held by

the agency companies and the net proceeds from the operations of these companies under their respective agreements in excess of the nominal amounts of six percent on their capital stock. No interest ran on any of these accounts.

Where Airco acquired a plant by issuance of its stock, the stock was given an exchange rate or value in the contract for the purchase of the property and the agreed value of the stock issued to purchase the property was used as the amount of the credit to the accounts payable to Airco on the subsidiary's books and as the amount of the debit to the accounts receivable from the subsidiary on the parent's books. Thus, all assets held and used by the petitioners in 1938 were furnished by Airco which paid for them with its own cash or by exchange of its own stock.

Airco and its four subsidiaries had 28 officers during the year 1938. The salary of each officer was originally paid out of the funds of Airco. *C. E. Adams* was chairman of the board of directors of all the companies and "Chairman of Company" of Airco and Sales. He was the chief executive officer of Airco and Sales. *A. R. Ludlow* was vice-chair-[fol. 22] man and director of Airco and Sales; president and director of Carbonic; and director of Welder. *C. S. Munson* was director of Carbonic and Welder; and president and director of the other three. *T. B. Hasler* was president and director of Welder. *M. W. Randall* was vice-president of Airco, Sales and Welder; and vice-president and director of Carbonic for a part of the year. *H. Van Fleet* was vice-president and operating manager of Airco and Sales; and director of Sales, Carbonic and Welder. *C. D'W. Gibson* was "vice-president in charge of sales" of Airco and Sales. *W. C. Keeley* was vice-president of Airco and Sales; and director of Carbide and Welder. *F. J. Metzger* was "vice-president in charge of development and research" of Airco and Sales. *W. W. Ogier, Jr.*, was executive vice-president and director of Carbonic for a part of the year. He died December 28, 1938. *R. J. Rowen* and *T. W. Gibson* were vice-presidents of Carbonic. *G. C. Cusack* was "vice-president in charge of sales" of Carbonic for a part of the year. *E. C. Ackerman* was vice-president of Carbide. *R. B. Davidson* was secretary of all the companies, and director of Sales and Carbonic. *R. W. Ryder* was treasurer of all the companies. *E. C. Turner* and *L. A. Hull* were assistant vice-presidents of Airco and Sales. *G. E. Hawkins* and *R. A. Sossong* were assistant vice-presi-

dents of Airco and Sales; and vice-presidents of Carbonic. *T. G. Harrison, E. R. Humann* and *A. J. Thoma* were assistant secretaries of all the companies. *E. R. Holmes, F. J. McCulloch, J. E. Bowman* and *F. B. Adams, Jr.* were assistant treasurers of all the companies. *A. Anderson* was assistant treasurer of Welder. With one or two minor exceptions each of the above-mentioned 28 officers had offices in the general offices of Airco and its four subsidiaries.

The officers of Airco administered and managed the business of the three petitioners and Wilson Welder & Metals Co., Inc. in accordance with the policies determined by the Airco board of directors in 1938 and prior years through the substantial identity of Airco's officers with those of each agency company.

The business of Airco and its four agency companies was divided into six main branches directed by five vice-presidents and one assistant vice-president of Airco. These six [fol. 23] branches were: corporate, operations, sales, financial, distribution and research.

Randall was in charge of the "corporate" branch. He had under his supervision C. R. Spence, Davidson, Ogier (part of the year) and Cusack (part of the year). Spence was in charge of the business relations bureau for all the companies. Davidson had under his supervision Harrison, Humann and Thoma. Harrison had charge of the legal work and contracts for all the companies. Humann had charge of Federal taxes and general audits for all the companies. Thoma had charge of insurance and state and local taxes for all the companies. Practically all the insurance of the group was taken out in the name of Airco and collected by Airco when occasion for collection on a loss occurred. Ogier and Cusack had charge of 18 district sales offices for Carbonic. Some of these district offices were under a separate manager and others were under a joint manager for Carbonic and Sales. The district offices at Seattle, Washington, Portland, Oregon and New Orleans were under a joint manager. The employees there served both Carbonic and Sales.

Van Fleet was in charge of the "operations" branch. He had under his supervision Turner and Sossong and five department heads, namely, J. H. Allen, D. M. Hasbrauck, W. E. Mock, J. J. Crowe and J. L. Anderson. Allen acted as assistant to Van Fleet and was given special assignment. Hasbrauck was the manager of an apparatus manufactur-

ing plant for Sales and Carbonic and the head of a general stores department for all the companies. There were about 26 district stores established throughout the United States where Airco products were warehoused and held for distribution to customers. Mock was the chief inspector at the above-mentioned apparatus manufacturing plant. Crowe was in charge of the department that conducted research and development (except engineering research) of methods and processes employed in the application of oxygen and acetylene to welding and cutting. Here occurred the development of the first models of torches, acetylene regulators, and, in general, all the manual as distinguished from machine tools and appliances used with the gases manufactured by Sales, Carbonic and Welder. Anderson was [fol. 24] in charge of the engineering research department. This department handled that part of the research and development that was carried on by machinery as distinguished from manual methods. It maintained a research laboratory at Jersey City and performed research services for Sales, Carbonic and Welder. Turner had under his supervision J. E. Fricker who was the chief engineer for all of the companies. As chief engineer Fricker had charge of the design of buildings and their construction, the design of mass concrete and its construction, and the mechanical design and installation of plant equipment. Sossong had under his supervision three plant managers, C. G. Andrew, H. W. Hill and C. A. Wallin. Andrew was general superintendent of those gas plants manufacturing oxygen, hydrogen, nitrogen, carbon dioxide (both liquid and solid) and the rare gases. There were at least eight such plants scattered through the United States that were used jointly by Sales and Carbonic. Hill was general superintendent of the acetylene plants for Sales. During 1938 about 48 percent of the calcium carbide produced by Carbide was transferred to Sales for use in these acetylene plants. Wallin was manager of a cylinder manufacturing plant for Sales. After the cylinders were manufactured the ownership thereof was transferred to Airco.

C. D'W Gibson was in charge of the "sales" branch. He had charge of the sales made by all of the companies except Carbonic. The sales made by Carbonic were under the general supervision of Randall as previously stated. Gibson had three assistants. He also had under his supervision five

department managers and 25 district offices with each headed up by a district manager. The five department managers were E. F. Péttigrew, H. L. Rogers, C. B. Armstrong, H. W. Reade and G. Van Alstyne. Pettigrew managed the gas sales; Rogers the applied engineering; Armstrong the railroad sales; and Reade the apparatus sales. Van Alstyne was the advertising manager for all the companies. This department published notices of dividends to Airco stockholders, intercompany bulletins, a general "Airco" catalog, special bulletins and technical pamphlets, and arranged exhibits at various pubic expositions covering all the Airco products.

[fol. 25] Keeley was in charge of the "financial" branch. He had under his supervision Ryder and Hull. J. Bonapart was audito for all the companies and was responsible directly to Keeley. Ryder as treasurer for all the companies had under his supervision Holmes, H. M. Daggett, McCulloch, Bowman, W. Winters, Jr., F. B. Adams, Jr., W. A. Bower, D. Allen and also the New York office service for all the companies. Holmes had charge of the payroll section for all the companies. Daggett was purchasing agent for all the companies. Emergency expenditures not in excess of $50 could be made without authorization. Expenditures between $50 and $500 were made on construction, maintenance and betterments orders, or construction production orders, on an appropriation basis, requiring the approval of an executive officer of Airco, but not the approval of the board of directors or the chairman. Any expenditure over $500 had to be requested by the head of the department requiring the expenditure, and it went before the Airco board of directors and was approved or disapproved at their pleasure. Materials purchased for one subsidiary were often transferred to another subsidiary. Where this was done, the transfer was reflected on the accounting records at cost through intercompany accounts without the passage of any cash. Likewise, products produced by one subsidiary were sometimes transferred to another subsidiary for its use or for sale to outsiders. When such transfers were made, they were also reflected on the accounting records at cost, through inter-company accounts payable and accounts receivable, without the passage of any cash between the companies. McCulloch had charge of the cash section for all companies. The cash was ac-

cumulated in the districts and transmitted to local accounts of which there were about 150, exclusive of the petty cash accounts. Each subsidiary had several separate bank accounts at plant and district office locations. McCulloch was empowered to draw on any of these accounts indiscriminately wherever cash was available over operating requirements. C. E. Adams, F. B. Adams, Jr., Ryder and Holmes could also sign checks, drafts and orders for all the companies; Ludlow could sign for Airco, Sales and Carbonic; Munson could sign for Airco, Sales and Carbide; [fol. 26] Randall could sign for Airco, Sales and Welder; Keeley and Hull could sign for Airco and Sales; Ackerman could sign for Carbide; Hasler and Andersen could sign for Welder; and Ogier, Rowen and T. W. Gibson could sign for Carbonic. Two signatures were necessary in each case. The district offices made daily reports of cash received and petty cash paid out and bank deposits and from this was made up the combined daily cash report for Airco and twice each month this consolidated cash report was submitted to the board of directors of Airco. All of this was under the cash section. Bowman's particular work was in auditing the accounts receivable, petty cash and stores of the field and district office accounts. Winters was credit manager for all the companies. He had complete responsibility for authorization of credit in the district offices and in the New York office. He delegated this authority through his credit clerks in the field who reported to him twice each month showing the delinquent balances for all accounts of about 60,000 customers. F. B. Adams, Jr., was in charge of the pension policy section for all the companies and was also given special assignments. There were two pension plans for Airco and its four subsidiaries. The first plan covered services rendered by all employees of all the companies prior to May 1, 1935. The second plan covered services rendered by all employees of all the companies after May 1, 1935. The first plan provided for retirement income out of a trust fund established and entirely supported by Airco by contributions to a fund on deposit with Bankers Trust Company. The second plan was maintained by the joint contribution of Airco and the individual employee. Airco contributed approximately 60 percent and the individual employee approximately 40 percent, and their joint contribution was used to purchase a group annuity contract

with the Aetna Life Insurance Company. Bower was field office manager for Sales and Carbonic and dealt principally with personnel questions. Allen was manager of cylinder records for Airco, Sales and Carbonic. Title to all gas cylinders was retained by Airco. Cylinders were allocated between Sales and Carbonic as required. In 1938 Airco had approximately 850,000 cylinders in service of which 600,000 were in service for Sales and 250,000 for Carbonic. Hull had under his supervision Ackerman, R. F. [fol. 27] K. Tothill and Hasler. Ackerman looked after a certain type of sales by Carbide, such as mine lamp and house lighting which did not fit into the standard Airco products. He also handled special types of direct mail advertising to that kind of trade, and also handled direct carload shipments. Tothill was the operating manager of the two carbide plants at Keokuk and Ivanhoe for Carbide. Hasler as president of Welder had charge of an assembly plant and looked after certain special sales to jobbers. The general accounting department of the financial branch under Bonapart was located in the general offices at New York. Separate books were kept for each subsidiary. Uniform methods of accounting were employed for all the companies and the accounts were kept strictly in accordance with the operating or agency agreements. Each subsidiary credited to Airco as an accounts payable the amount of working capital furnished the subsidiary by Airco, and also the net proceeds from its operations in excess of six percent on its capital stock. Airco recorded such amounts on its books as accounts receivable due from the subsidiaries. No interest ran on any of these accounts. Intercompany accounts were cleared monthly through the parent's books on consolidation of the accounts of the subsidaries.

Hawkins was in charge of the "distribution" branch. He had under his supervision S. B. Stouffer, E. C. McClintic, T. P. Keevins and H. B. Welsh. Stouffer was assistant distribution manager for all the companies. He handled the distribution of all products from plants and warehouses to customers. McClintic was traffic manager for Carbonic. He handled mainly the dry ice, steel tubes, all the traffic handled in leased cars or standing in warehouse. Keevins was traffic manager for all the companies except Carbonic. Welsh was the truck supervisor for all the companies.

Metzger was in charge of the "research" branch. He had

under his supervision W. Wilkinson, a research engineer; W. G. Fogg, the chief chemist; F. R. Balcar, in charge of rare gas research; and C. C. Van Nuys, the chief physicist. All these men performed services for all the companies. This branch carried on extended research in connection with the production of synthetic alcohol in 1938, and in the improvements of the Airco products. It increased the [fol. 28] purity of oxygen from about 98 percent to 99.5 percent. It also has developed the processes for getting all the rare gases that all the companies can market.

The board of directors of Airco met 22 times during 1938, which was twice each month except January and July. The board of directors of Sales met five times during 1938; Carbide once; Carbonic twice; and Welder twice. Airco had 16 directors during 1938; Sales 5; Carbide 3; Carbonic 7; and Welder 7. C. E. Adams and Munson were directors in all the companies. Ludlow was a director in all the companies except Carbide.

During the year 1938 Airco also owned an interest in three other corporations operating under the name of Magnolia Airco Gas Products Company, Crystal Pure Carbonic, Inc., of Texas and Commercial Acetylene Supply Company, Inc. These three companies operated as separate companies and not as branches or divisions of Airco and returned their respective incomes separately and are not involved in these proceedings. Some of the profits of these three companies were declard as dividends to Airco and their accumulated profits appeared as surplus on their balance sheets, rather than as accounts payable to Airco as in the case of petitioners herein.

The method by which Airco conducted its business through corporate agencies was consistently adhered to and all details of the relationship between Airco and each of its corporate agencies or divisions were always fully disclosed to the Government and the Commissioner.

Petitioners were the corporate agents of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six percent of petitioners' outstanding capital stock belonged to and was the income and property of Airco as principal.

OPINION

BLACK, *Judge:* The issue which we have to decide in this proceeding is: Whether, as the respondent has determined, the income from the operations of the three petitioners belonged not to Airco, the parent but to the petitioners and was taxable to them; or whether, as the three petitioners [fol. 29] contend, the income from the operations of the petitioners in 1938, exclusive of the small amounts paid to petitioners under the contracts, belonged and was taxable to Airco, the parent company, both because the petitioners were in fact incorporated departments, divisions or branches of Airco's business and because the petitioners operated pursuant to express contract with Airco.

There was another subsidiary of Airco which operated in the same manner as the petitioners, Wilson Welder & Metals Co., Inc. but it is not a party to these proceedings. Concededly there was a loss from its operations in 1938 and the Commissioner has not determined any deficiency against it.

In our findings of fact we have endeavored to give a full and complete picture of the method of operations of petitioners as agents or branches or divisions of Airco. Therefore, in our discussion of the issue which we have to decide we shall endeavor not to unnecessarily repeat these facts.

It requires scant citation of authorities to establish the principle that normally corporations are separate juristic persons and are to be so treated for tax purposes. See *Burnet* v. *Commonwealth Improvement Co.* 287 U. S. 415, 11 AFTR 1099. Likewise mere ownership by one corporation of all of the stock of a subsidiary does not of itself merge the two corporations or create the relationship of principal and agent between them. There are exceptions, however, particularly where the subsidiary is so much a part of the parent in its operations that it amounts to no more than a mere department or agency.

It is the contention of petitioners that their manner of organization and their method of operation during the taxable year and for many years prior thereto bring them within the latter classification and that their entire net income, outside of the nominal amounts retained by each of them under the terms of their respective contracts with the parent corporation, Airco, belonged to Airco and should have been returned for taxation by that corporation and

that it was so returned by the parent corporation and taxes were paid thereon. In support of their contention petitioners rely principally upon *Southern Pac. Co.* v. *Lowe*, 247 U. S. 330, 3 AFTR 2989; *Munson S. S. Line* v. *Commissioner*, 77 Fed. (2d) 849, 16 AFTR 197 and *North Jer-*
[fol. 30] *sey Title Ins. Co.* v. *Commissioner*, 84 Fed. (2d) 898, 18 AFTR 233.

Respondent on his part contends that the foregoing authorities are not applicable and that each of the petitioners is taxable on its own net income regardless of any contract or agreement or method of operation which petitioners may have followed. Among the authorities cited by respondent to sustain his determination are: *Burnet* v. *Commonwealth Improvement Co., supra; Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, 30 AFTR 1310; *Maine Central Transportation Co.*, 42 B. T. A. 350; *Eskimo Pie Corporation*, 4 T. C. 669, affirmed *per curiam* 153 Fed. (2d) 301.

We have carefully examined the authorities cited by petitioners and respondent and have studied them in the light of the facts present in the instant case and we think that the facts which we have here bring petitioners within the ambit of the cases relied upon by them rather than those relied upon by respondent.

The Supreme Court in *Southern Pac. Co.* v. *Lowe, supra*, held that the distributions which were in issue in that proceeding were not dividends for the reason that the Central Pacific and Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former as stockholder and in other respects. The Court said in part:

> • • • While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control. • • •

We think the foregoing words of the Supreme Court are aptly descriptive of the relationship which existed between petitioners and their parent, Airco, in the instant case. We summarize as follows some of the facts which have brought us to this conclusion: The capital stock of each petitioner is nominal in amount and is all owned by Airco. The members of the board of directors of each petitioner

are elected by Airco and, with one exception, they are all senior executive officers of Airco. The chairman of the [fol. 31] board of directors of Airco was also chairman of the board of directors of each petitioner. The president of Airco was also a director of Airco and of each petitioner. The Airco board held regular meetings and exercised complete domination and control over the business of Airco and each of the petitioners. The board of directors of the petitioners held an organization meeting each year and thereafter only met when called upon by Airco to formalize action taken by the Airco board. The chairman, vice-chairman and president of Airco were in charge of the administration and management of the activities of each petitioner and carried out the policies and directives with respect to each petitioner as promulgated by the Airco board. One main office was maintained for Airco and the petitioners in the Lincoln Building, New York, N. Y., and, with two minor exceptions, the offices of all the executive officers of Airco and the petitioners were located there. All assets held by each petitioner were furnished to it by Airco which paid for them with its own cash or stock. Airco supplied all the working capital of each petitioner. The business of the parent and the petitioners was conducted as one business unit divided into six branches: corporate operations, sales, financial, distribution and research. Each of the six main branches was directed by a senior officer of Airco. The subdivisions of each of the six branches were also directed and managed by officers of Airco. All employees in each of the six branches performed their duties for Airco and each petitioner whenever and wherever their services could be utilized in connection with the operations of any of the petitioners. All expenditures for Airco and each petitioner of more than $500 required specific approval of the Airco board of directors and its chairman. Advertising was conducted under one advertising manager and through this medium Airco represented to its stockholders and the general public that the petitioners were divisions of the parent company. All purchases for each petitioner from persons outside the affiliated group, except emergency purchases up to $50, were made only upon orders issued by the general purchasing agent of Airco. Products produced by or materials purchased for one agency company were often transferred [fol. 32] to another agency company. Where this was

done the transfer was reflected on the intercompany accounts at cost without the passage of any cash. There were no intercompany profits. All bank accounts maintained in the name of each petitioner were treated by Airco as its own and were drawn upon indiscriminately by it when money was needed by any company. There was substantial identity of officers authorized to sign checks on the bank accounts of Airco and on the bank accounts of each petitioner. All credits and collections were in charge of the Airco credit manager. Airco maintained pension systems for all employees of all companies. Accounting was done for all companies by one general accounting office under the general auditor of Airco and accounting procedure was uniform. The proceeds realized from each petitioner's activities did not come to Airco as the result of any independent action by the agency company, such as declarat-on of dividends. A written operating agreement was entered into between Airco and each petitioner under which the petitioner agreed to conduct a branch of the Airco business for a purely nominal fee. In each agreement the agency company agreed to credit, and did credit, monthly on its books to Airco all profits from its operations above the nominal amount of its compensation. The accounts between Airco and each petitioner were kept strictly in accordance with each operating agreement.

It is true, of course, that taken separately some of the foregoing facts would not be sufficient in themselves to make inoperative the general rule that corporations are separate juristic persons and are to be so treated for tax purposes. We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra.*

The Circuit Court of Appeals of the Second Circuit held in *Munson S. S. Line* v. *Commissioner, supra,* that the taxpayer, Munson Line, should be deemed the owner of each vessel held by and documented in the name of its wholly owned subsidiaries. In thus holding, the court, among other things, said:

> * * * The situation is similar to that involved in *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 38 S. Ct. [fol. 33] 540, 62 L. Ed. 1142, where the court held that there was practical identity between the Central Pacific and the Southern Pacific because of the complete owner-

> ship and control which the latter corporation possessed over the former. Thus even in tax cases the separate identity of corporations may be disregarded in exceptional circumstances. See, also, *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71, 39 S. Ct. 35, 63 L. Ed. 133; *New Colonial Ice Co.* v. *Helvering*, 292 U. S. 435, 442, 54 S. Ct. 788, 78 L. Ed. 1348. * * *

Respondent in support of his determination relies heavily upon *Interstate Transit Lines* v. *Commissioner*, *supra*, which affirmed 130 Fed. (2d) 136 which in turn affirmed our decision in 44 B. T. A. 957. We think that case is clearly distinguishable from the instant case on its facts. In the *Interstate Transit Lines* case the taxpayer (a Nebraska corporation) operated an interstate bus line between Illinois and California, and Missouri and Wyoming. Under California law as it existed prior to 1937, the petitioner, being a foreign corporation, was prohibited from doing an intrastate business in California. In order to handle such local business on its buses, the taxpayer organized a California bus corporation named Union Pacific Stages of California and made an agreement with that corporation under which the California corporation was to take over the operation of Interstate's buses at the state line and operate them in California for its benefit and under its direction, the profits to be paid to Interstate and any deficit to be borne by it. In the year 1936 the California corporation had an operating deficit of $28,100.66 and Interstate paid that amount to the California subsidiary and deducted it as a business expense in its own return. The Supreme Court, sustaining the decisions of the lower courts, held the deduction improper. The decision of the majority of the Court was placed squarely upon the ground that the subsidiary was engaged in a business which the parent corporation could not lawfully do, hence that the parent corporation could not claim the deduction as an ordinary and necessary expense of its business. The majority opinion pointed out that "an income tax deduction is a [fol. 34] matter of legislative grace and that the burden clearly showing the right to the claim deduction is on the taxpayer." The Court then said:

> This is not the case of a mere branch or division of a business conducted solely for convenience's sake under a separate corporate form. Petitioner did an

> interstate bus business and was a corporation foreign to California. On the other hand the business of Stages in the tax year in question was both interstate and intrastate. For petitioner to engage in intrastate business in California was, on the findings, illegal.
>
> • • •

The Court also pointed out that even if it could be claimed that the intrastate business done by the subsidiary was legitimate business of the parent corporation, the record failed to show what part of the deficit, if any, resulted from that business as distinguished from the local business so that no part of the deduction could be allowed.

We have no such facts in the instant case as existed in *Interstate Transit Lines, supra.* The Commissioner makes no contention that Airco and its subsidiaries operated in the manner shown in our findings of fact because it was illegal for Airco to do such business on its own account. On the contrary the evidence affirmatively shows that such was not the reason for the manner of operation by Airco and its subsidiaries. The reasons which did prompt such method of operation are fully set out in our findings of fact and need not be repeated here. Moreover the issue in the instant case is altogether different from what it was in the *Interstate* case. In the *Interstate* case the issue was one of deduction for ordinary and necessary business expense. We have no such issue here. The issue is squarely whether the income of the subsidiaries is taxable to them because it was their income or whether, because they were operated as branches or divisions of Airco and each under a contract which clearly disclosed the relationship, the net income of these subsidiaries was taxable to Airco. That is the issue.

Petitioners make no contention that if they lose on this issue they are in the alternative entitled to deduct as business expenses the amounts of income which they turned over to Airco. They concede that if the issue which is [fol. 35] raised by the pleadings is decided against them, then the deficiencies are those which have been determined by respondent. On the other hand, respondent concedes that if the issue raised by the pleadings is decided in favor of the petitioners, then there are no deficiencies.

As we have already stated, we think the law and the facts are on the side of petitioners and we, therefore, decide in their favor.

Los Angeles & Salt Lake Railroad Co., 4 T. C. 634, was not cited or relied upon by the Commissioner in his brief. However, we think it is appropriate to point out that one of the issues in that case was similar to that involved in *Interstate Transit Lines, supra*, and we decided it in the same way as we had decided in the *Interstate* case. As one of the authorities for such decision we cited the *Interstate* case. If the distinction which we have made above between the *Interstate Transit Lines* case and the instant case is sound, as we think it is, then undoubtedly the same distinction applies to *Los Angeles & Salt Lake Railroad Co., supra.*

It may be argued, although not stressed in respondent's brief, that consolidated returns by affiliated corporations were denied generally by the Revenue Act of 1934 and therefore on that account, if no other, petitioners should not prevail in this proceeding. We are not unmindful of this change in the law effected by the 1934 Act and we have no purpose to impinge upon it. However, we do not believe that this change in the law affected that narrow class of corporations which are conducting their operations in the manner such as described by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra.* The respondent himself evidently so construed the law so far as petitioners were concerned, because it was not until the taxable year 1938 that he refused to recognize Airco's right to return the income of petitioners as its own.

So far as the record shows the income tax returns of Airco and petitioners for the years 1935, 1936 and 1937 were not disturbed although they were filed on the same basis as in the taxable year and were all years subsequent to 1934 when Congress amended the law so as to deny the privilege of filing consolidated returns to affiliated corporations generally. [fol. 36] Of course, respondent is not in any way estopped to do what he has done in the instant case by any action of his in the years 1935, 1936 and 1937. Nevertheless we think that his apparent interpretation of the law in 1935, 1936 and 1937 as it affected petitioners was correct and that the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra,* still stands.

Reviewed by the Court.

Decisions will be entered for the petitioners.

Van Fossan, Arnold, and Opper, JJ., dissent.

[fol. 36-2] IN THE TAX COURT OF THE UNITED STATES

Docket No. 5822

NATIONAL CARBIDE CORPORATION, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (without Bureau symbols) dated May 19, 1944, and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation of the State of Delaware with its principal office at 60 East 42nd Street, New York, N. Y. The return for the period here involved was filed with the Collector for the Third District of New York.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to petitioner on May 19, 1944.

3. The taxes in controversy are $122,285.56 in income tax and $101,019.08 in declared value excess profits tax for the year ended December 31, 1938.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

The addition to petitioner's income of $881,244.30, which represented the net amount received by petitioner as agent [fol. 36-3] for Air Reduction Company, Incorporated in the taxable year and against which there have been allowed deductions of $4 representing capital stock tax paid by said Air Reduction Company, Incorporated and $39,214.78 representing a percentage of the expenses of said Air Reduction Company, Incorporated.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Air Reduction Company, Incorporated is a New York corporation, and its principal business is and was in the taxable year the manufacture and sale of oxygen and other

gases, acetylene and carbide, and also welding and cutting apparatus and other appliances for the use of its products. It has its principal office at 60 East 42nd Street, New York, N. Y.

(b) Petitioner is and was in the taxable year a branch of the business of Air Reduction Company, Incorporated.

(c) All of the issued and outstanding capital stock of petitioner is owned and was owned in the taxable year by Air Reduction Company, Incorporated. In the taxable year the same individuals held the offices of Chairman of the Board and President of both petitioner and Air Reduction Company, Incorporated and substantially all of the other officers and directors of petitioner were officers of Air Reduction Company, Incorporated. In the taxable year petitioner's working capital was furnished by Air Reduction Company, Incorporated. The accounts of both petitioner and Air Reduction Company, Incorporated were kept in the taxable year at the principal office of Air Reduction Company, Incorporated by the same accounting staff.

(d) In the taxable year and for several years prior thereto under a written agreement executed on August 25, 1922, and a written agreement supplementary thereto [fol. 36-4] executed on August 1, 1936, Air Reduction Company, Incorporated employed petitioner as agent to manage and operate certain plants producing carbide mainly and to market and sell the output thereof.

(e) The only income which petitioner was entitled to receive and did receive in the taxable year for its own account was $300 representing compensation for its services as agent under the said agency agreements, and all other amounts in the taxable year were received by petitioner as agent for Air Reduction Company, Incorporated.

(f) Petitioner duly reported the sum of $300 on its return for the taxable year and paid the tax thereon.

(g) On its return for the taxable year Air Reduction Company, Incorporated duly reported the amounts received by petitioner as agent, took the deductions relating thereto, and paid the tax on the resulting net income therefrom.

(h) Respondent determined that petitioner was taxable on all amounts received in the taxable year and increased

its net income as reported by $881,244.30, being the net of the gross amount received of $1,430,523.76 and the deductions relating thereto of $548,979.46, less the amount of $300 reported. Such income in excess of the $300 reported belonged and was taxable to Air Reduction Company, Incorporated as principal and not to petitioner, its agent.

Wherefore, the petitioner prays that this Court may hear the proceeding and find that there is no deficiency.

Winfield A. Huppuch 2d, Attorney for the Petitioner,
55 Wall Street, New York 5, N. Y.

(Verified August 15, 1944.)

[fol. 36-5] EXHIBIT A, ANNEXED TO PETITION

(Cert. tr., pp. 8-11)

Treasury Department, Internal Revenue Service, New York, N. Y.

Office of Internal Revenue Agent in Charge, U. S. Parcel Post Building, Upper New York Division

May 19, 1944.

National Carbide Corporation, 60 East 42nd Street, New York, N. Y.

GENTLEMEN:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1938 discloses a deficiency of $122,285.56, and that the determination of your declared value excess-profits tax liability for the year mentioned discloses a deficiency of $101,019.08, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States at its principal address, Washington, D. C., for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, 341 Ninth Avenue, New York 1, N. Y., for the attention of UNY:CONF:WAMcK. The sign-[fol. 36-6] ing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours, Joseph D. Nunan, Jr., Commissioner, by William A. Silk, Acting Internal Revenue Agent in Charge.

Enclosures: Statement, Form of Waiver.

Statement

National Carbide Corporation, 60 East 42nd Street, New York, N. Y.

Tax Liability for the Taxable Year Ended December 31, 1938

	Liability	Assessed	Deficiency
Income tax	$122,323.06	$37.50	$122,285.56
Declared value excess-profits tax	101,019.08	None	101,019.08
Total	$223,342.14	$37.50	$223,304.64

In making this determination of your income tax and declared value excess-profits tax liability, careful consideration has been given to the report of examination dated [fol. 36-7] March 17, 1943; to your protest dated May 21, 1943; and to the statements made at the conferences held on June 7, 1943, November 10, 1943, December 7, 1943, and March 21, 1944.

A copy of this letter and statement has been mailed to your representative, Mr. Earle M. Williams, 1 East 44th Street, New York, N. Y., in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Adjustments to Net Income

Net income as disclosed by return		$300.00
Unallowable deductions and additional income		
(a) Additional income		881,244.30
Total		$881,544.30
Nontaxable income and additional deductions		
(b) Capital stock tax	$4.00	
(c) Expenses of Air Reduction Co. Inc.	39,214.78	39,218.78
Net income adjusted		$842,325.52

Explanation of Adjustments

(a) and (c) All of your capital stock is owned by Air Reduction Company, Inc., and, on your return, all of your net income in excess of $300.00 was deducted and allocated to the parent company on the theory that you were an [fol. 36-8] agent for said company. It is held that as a corporate entity, operating as such, you are taxable on your separate income. Such expenses as were paid or accrued by Air Reduction Company, Inc., attributable to your operations have been allocated to you under section 45 of the Revenue Act of 1938.

(b) This item is explained in the copy of the report furnished you and is not protested.

Computation of Tax

Declared value excess-profits tax	
Taxable net income	$842,325.52
Less:	
10% of $3,999.00 value of capital stock as declared in the capital stock tax return for year ended June 30, 1938	399.90
Net income subject to declared value excess-profits tax	$841,925.62
5% of declared value of capital stock	199.95
Balance	$841,725.67
Declared value excess-profits tax:	
6% of $199.95	$12.00
12% of $841,725.67	101,007.08
Total declared value excess-profits tax	$101,019.08
Declared value excess-profits tax assessed	None
Deficiency of declared value excess-profits tax	$101,019.08
[fol. 36-9] Income tax	
Taxable net income	$842,325.52
Less:	
Declared value excess-profits tax	101,019.08
Net income	$741,306.44
Tentative tax:	
19% of $741,306.44	$140,848.22
Less:	
2½% of the dividends paid credit	18,525.16
Total income tax	$122,323.06
Income tax assessed:	
Original, account No. 412101	37.50
Deficiency of income tax	$122,285.56

(*Note:* The petitions of Air Reduction Sales Company and Pure Carbonic, Inc., to the Tax Court, which are contained in the Certified Transcript of Record at pages 467-476 and 495-507 respectively, are the same as the foregoing petition, in all material respects, except for the dates of

the agency agreements and the amounts of income, taxes, and claimed deficiencies mentioned therein.)

[fol. 36-10] IN THE TAX COURT OF THE UNITED STATES

ANSWER

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition heretofore filed in this proceeding admits and denies as follows:

1, 2, 3. Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

4. Denies that the respondent erred as alleged in paragraph 4 of the petition.

5 (a). Denies the allegations contained in subparagraph (a) of paragraph 5 of the petition, except that it is admitted that Air Reduction Company, Incorporated is a New York corporation and that it has its principal office at 60 East 42nd Street, New York, New York.

(b). Denies the allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c). Denies the allegations contained in subparagraph (c) of paragraph 5 of the petition, except that it is admitted that all of the issued and outstanding capital stock of petitioner is owned, and was owned in the taxable year, by Air Reduction Company, Incorporated.

5 (d), (e). Denies the allegations contained in subparagraphs (d) and (e) of paragraph 5 of the petition.

(f). Denies the allegations contained in subparagraph (f) of paragraph 5 of the petition, except that it is admitted that the petitioner reported the sum of $300 on its tax return for the taxable year involved herein and that it paid a tax on said sum.

[fol. 36-11] (g). Denies the allegations contained in subparagraph (g) of paragraph 5 of the petition.

(h). Denies the allegations contained in subparagraph (h) of paragraph 5 of the petition, except that it is ad-

mitted that the respondent determined that the petitioner is taxable on all amounts received by it in the taxable year and increased its net income as reported by $881,244.30, being the net of the gross amount of income received by petitioner in the amount of $1,430,523.76 and the deductions relating thereto in the amount of $548,979.46, less the amount of $300 reported by the petitioner on its return.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the petitioner's appeal be denied and that the Commissioner's determination be in all respects approved.

J. P. Wenchel, E. C. A.; J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel: E. C. Algire, Division Counsel; Sidney B. Cambill, Special Attorney, Bureau of Internal Revenue.

[fol. 36-12] IN THE TAX COURT OF THE UNITED STATES

[Three titles omitted]

STATEMENT OF EVIDENCE AND PROCEEDINGS—November 13, 1945

The Clerk: The Tax Court of the United States is now in session; Judge Eugene Black presiding.

The Court: The Clerk will call the cases that are set for hearing today.

The Clerk: 5822, National Carbide Corporation; 5823, Air Reduction Sales Company; 5824, Pure Carbonic, Inc.

The Court: Will these cases be consolidated for hearing, or is it the desire to hear all three at the same time?

Mr. Wilson: Your Honor, I move that the three cases be consolidated for hearing and decision, and I understand that the attorney for the Respondent joins in that motion.

Mr. Maddox: I have no objection to the consolidation. I think they should be consolidated.

The Court: Very well. An order will be entered consolidating for hearing these three proceedings.

Are you ready to begin the hearings?

Mr. Wilson: We are ready to proceed, your Honor.

Mr. Maddox: Respondent is ready.

The Court: Note your appearances for the Petitioner and the Respondent, please.

Mr. Wilson: John A. Wilson, Willard M. L. Robinson, and W. A. Huppuch, II.

Mr. Maddox: James C. Maddox for the Respondent.

The Court: While I have read the pleadings in the case, perhaps you would like to make a brief opening statement.

Mr. Wilson: Yes.

[fol. 36-13] OPENING STATEMENT ON BEHALF OF PETITIONERS

BY MR. WILSON

Mr. Wilson: If it please the Court, these three cases involve Federal income taxes and declared value excess profits taxes for the calendar year 1938, and the aggregate claimed deficiency is $1,066,000.

Each of these three Petitioners is a wholly-owned subsidiary by the parent company, Air Reduction Company, Inc., which will sometimes be referred to here as Air Reduction or Airco.

The three Petitioners are National Carbide Corporation, Air Reduction Sales Company, and Pure Carbonic, Inc.

There is a fourth company which will be mentioned rather frequently in the course of the proof, which is also a wholly-owned subsidiary of Airco. That is the Wilson Welder and Metals Company. However, it is not a petitioner, and the parent company, Air Reduction Company, is not a petitioner in this proceeding.

Now, the alleged deficiencies against the three petitioners in income taxes and in declared value excess profits taxes aggregate, as I have said, $1,066,000. Of that sum, there is a claimed aggregate deficiency in income tax against the three petitioners of $583,000, and an aggregate claimed deficiency against the three petitioners in declared value excess profits taxes of about $483,000.

Now, in order that your Honor may evaluate more readily and clearly what I subsequently will say, I think perhaps I might state at this point the principal issue in this case in rather summary form.

The principal question, as we see it, will boil down to this: whether, as the Respondent has determined, the in-

come from operations of these four subsidiaries belong not to Airco, the parent, but to the subsidiaries, and is taxable only to them, because they were separate and in-
[fol. 36-14] dependent corporate entities and neither contractual agents of Airco nor incorporated departments, branches, or divisions of Airco's business.

That is the position which the Commissioner has taken.

On the other hand, the Petitioners have contended—and this is the other side of the issue—that the income from the operations in the year 1938 of these four subsidiaries, belonged and was taxable only to Airco, the parent company, either because the subsidiaries were, in fact, as we believe and as we shall attempt to prove, incorporated departments, divisions, or branches of Airco's business, or because the subsidiaries were the agents of Airco by express contract, or because, on the assumption which we think would be rather remote, that even if they should be deemed independent corporate entities, the contractual obligations, long subsisting and binding between them and Airco, are nevertheless binding and enforcible for tax purposes.

Now, this case, on its facts, may seem rather complicated, and, since there are four subsidiaries involved, and we have consolidated these cases for hearing and decision, I should like the Court, if it will, to bear with me while I give a little background as to the corporate organization and business.

Airco, the parent company, is a New York corporation; was organized on November 26, 1915, and from its inception, Airco has always conducted its business through operating subsidiaries. Sometimes they will be referred to here as corporate agencies. There were four of these subsidiaries. Each had a written operating contract with the parent company.

Now, in the taxable year 1938, and, indeed, long prior to that time, Airco, the parent, was engaged in four major fields of business activity, in each of which it employed one of these subsidiary companies, and I should like to
[fol. 36-15] give a swift summary of those fields and the particular field in which each subsidiary operated.

The first of those subsidiaries, and the oldest of them, was the Air Reduction Sales Company. The branch of the business of Airco, which Sales Company carried on, consisted in manufacturing and selling the gaseous con-

stituents of air, principally oxygen and nitrogen and then certain rare gases, which are known as argon, neon, zenon, krypton, and helium.

The sales company also manufactured and sold acetylene, which is used together with oxygen, in a kind of companionate way, in what is known as the oxy-acetylene welding and cutting processes.

In addition, the Sales Company manufactured and sold apparatus for the use of these respective gases. And then we move to the second field or branch of Airco's activities.

That was carried on by a subsidiary known as the National Carbide Corporation. That subsidiary engaged in the manufacture and sale of calcium carbide, which was obtained, or is obtained, by fusing coke, and limestone, and the calcium carbide is used in part by Airco in making acetylene gas to supply its own requirements, and it is also used in part for sale to outside manufacturers of acetylene.

And then the third branch of Airco's business is carried on by Pure Carbonic, Inc. And this company manufactured and sold carbon dioxide. It sold it in several forms, in gaseous and in liquid form, and in those forms it is commonly known as carbonic acid gas or carbonic gas, and also in solid form, and then it is commonly known as dry ice.

Carbonic gas, I may say in passing, is primarily used in carbonation of beverages for human consumption. The dry ice is a rather unique refrigerant.

In addition, Pure Carbonic manufacturers and sells [fol. 36-16] apparatus for the use of these products and also containers for their transportation.

Now, as I have indicated, Airco had an operating contract with each of these subsidiaries. Under that contract, the subsidiary operated a branch of the business of Airco and under the contract it received a net annual compensation, equal to 6 percent per annum upon the outstanding capital stock of the subsidiary.

For convenience and for the record, I should like to list those:

The outstanding capital stock and the compensation, pursuant to the contracts of the three subsidiaries, and also the contract of Wilson Welder, were as follows:

The Sales Company, on a capital stock of $12,500 a year, received a compensation of $750.

The Carbide Corporation, on a capital stock of $5,000, received a compensation of $300.

Pure Carbonic, on a capital stock of $5,000, received a compensation of $300.

And Wilson Welder, on a capital stock of $10,000, received a compensation of $600.

Now, what were some of the basic provisions of these operating contracts? I shall not give them with undue detail at this time, but give the substantial provisions as they appear in almost identical form in each, and I may say that these operating contracts, your Honor, follow a pattern and a precedent which was established almost at the very inception of Airco's operations. These contracts were not some cute device consummated in December of this or any other taxable year. They represented a basic pattern, and were embedded in the realities of operations of those companies.

Now, these contracts will be in evidence, and I am, therefore, going to touch merely upon some of the basic provisions.

[fol. 36-17] Under the contracts, the operating contracts, Airco agreed to supply the subsidiary or operating company with working capital, and it did supply it. It agreed to provide for each subsidiary executive management, office accommodations and facilities. It agreed to give the subsidiary, and it did give the subsidiary, the use of all trucks, equipment and shipping facilities, and also gave the subsidiary the use of cylinders and containers—that is, it gave the Sales Company and Pure Air Carbonic, which dealt in gases, the use of those cylinders.

May I say at this point that the most essential, most valuable, and in some respects the most indispensable piece of equipment or apparatus were these cylinders, title to which was always retained in the parent Airco.

Now, what is the other side of the contract? The subsidiaries or operating companies agreed to manage and to operate efficiently the plants used in the production of products which it manufactured and sold; agreed to maintain the plants in first class condition, charging necessary repairs and replacements to operating expenses. It agreed to market and sell the output of the plants efficiently and to realize the largest possible gross return.

It agreed to pay all expenses of operations, maintenance and selling, and to discharge all expenses and liabilities incurred in the process of those operations, to collect all accounts receivable resulting from operations and then—and these are highly significant provisions—to credit monthly to the parent company, Airco, on the subsidiary's books, all profits accruing from the operations above an amount equal to 6 percent per annum on the outstanding capital stock of the subsidiary.

And then, further, the subsidiary agreed to pay over to Airco upon demand any profits becoming due and credited to Airco.

Now, in order to implement these operating contracts with each subsidiary, Airco found it desirable to have the [fol. 36-18] legal title to the plants and other assets used in the operations of the subsidiaries, held in the name of the subsidiaries. Such plants and assets the subsidiaries carried on their books, but they were offset in each case, and always have been, by an account payable by the subsidiary to Airco in the same amount.

Now, it is significant—I think highly significant—that all the fixed assets and plants and equipment used by these subsidiary companies pursuant to the contract were purchased by payment of Airco's own cash or by the issuance of its own stock. None of these operating subsidiaries ever invested a nickel in the plants or fixed assets, or other assets of those companies, and, as I have mentioned before, the title to the most valuable of the assets, the cylinders, was always held in Airco.

Now, I would like to give a brief—as briefly as I possibly can—resume of the expansion of Airco from 1915 up through the taxable year. I do that because I think it is necessary, in order to grasp the fact that Airco developed logically and reasonably as an integrated indu-trial unit. To grasp the fact that its basic pattern of organization, employing operating contracts with subsidiaries was established in 1917—20 years ago—and was always fully disclosed to the Government, and has always been consistently adhered to.

It is necessary in order to grasp the fact that the pattern was initiated—this pattern of operation—and evolved reasonably and logically in response to scientific requirements and to the demands of business efficiency and convenience.

First, the Sales Company—the oldest and earliest of the subsidiaries, the story starts with it. Now, in order to grasp the picture, it must be realized that the economical manufacture and distribution of oxygen, acetylene, and other gases requires a rather extensive geographical [fol. 36-19] distribution of plants. This was necessary in order to minimize the very heavy freight charges on these heavy cylinders used in transportation of gases and also to insure the prompt delivery throughout the country of these gases.

Now, in the period from 1915 through 1936, Airco organized or acquired by payment of cash—its own cash—or the issuance of its own stock, 41 of these local companies. They were engaged in the manufacture of oxygen, nitrogen, acetylene, and containers. Now, to overcome the decentralization of these companies, to coordinate production and sale and distribution of these products of these companies and other products, Airco, at the outset, adopted a policy of having the plants for the manufacture of these products operated and managed, and their output sold pursuant to operating contracts—the contents of which I have briefly summarized.

And in pursuance of that policy, Airco organized the sales company June 27, 1916, under the laws of Delaware. From the beginning Airco owned all its stock and, on March 1, 1917, Airco entered into the first operating contract which later became the pattern of all the rest, the contract with the Sales Company.

Now, the fixed assets of these 41 companies were acquired in the period of 1915 to 1936, and were transferred by Airco to the Sales Company. This was done—or, rather, I should say, to be more accurate,—by these 41 companies to the Sales Company at the specific direction of Airco, for the use by the Sales Company in carrying out its operating contract.

And, again, the significant fact is that these fixed and other assets used by the Sales Company were acquired by Airco by payment of its own cash or issuance of its own stock and then transferred to the Sales Company.

Then the National Carbide Corporation. I have already [fol. 36-20] mentioned the companionate use of oxygen and acetylene in the oxy-acetylene gas welding and cutting process.

In April, 1921, in order to supply its requirements for the manufacture of acetylene, Airco entered into the calcium carbide business. It acquired at that time the control of the National Carbide Corporation of Virginia, and that company was engaged in the manufacture of calcium carbide in two plants—one at Ivanhoe, Virginia, and the other at Keokuk, Iowa.

Then, on July 28, 1922, the National Carbide Corporation of Virginia organized the National Carbide Sales Corporation, and it held all the Sales Corporation's stock.

In August, 1922, the National Carbide Corporation of Virginia entered into an operating agreement with the Delaware corporation—the Sales Corporation—under which it employed the Sales Corporation to market and sell its products.

In August, 1927, Airco acquired all of the capital stock of National Carbide Corporation of Virginia.

In July, 1936, Airco dissolved the National Carbide Corporation of Virginia, and thereby became the owner of all its stock, including all the stock of the National Carbide Sales Corporation.

Then followed some transfers of assets and other corporate changes which I need not detail at this point, but the upshot, among other things, was that Airco succeeded to the rights of the National Carbide Corporation of Virginia under its operating agreement with the National Carbide Sales Corporation of Delaware—the agreement which had been entered into on August 25, 1922.

I should say in passing that that original agreement between the two carbide corporations involved, in the first instance, only the marketing and selling of the carbide products. Later on it was supplemented by a further agreement which included the broader provision to operate and manage the plants as well. That supplementary agreement [fol. 36-21] was entered into on August 1, 1936. In other words, the pattern and precedent which had been established in the operations of Airco and the Sales Company in 1917, and which had been found eminently satisfactory in practical operation was followed in the calcium carbide field as well.

Then, we come to the manufacture and sale of carbonic acid gas and dry ice. That was the very next and orderly step in progress in the field of gas manufacture. Airco

took over the production and distribution of carbonic gas and later of dry ice. Now, why was this a logical development? Airco had developed and was using some very special techniques for filling cylinders with oxygen. Similar techniques are necessary to fill cylinders with carbonic gas.

In addition, Airco maintained, in 1921, a distribution department which operated a very large fleet of trucks for delivery of oxygen cylinders, and it was thoroughly familiar with the very considerable problems of distribution involved in distributing throughout the country, in heavy cylinders subject to heavy traffic charges, a gas or a product which was relatively inexpensive.

The distribution of carbonic gas involved substantially the same problems as the distribution of oxygen, and so it was a natural step in development for Airco to enter that field. It did so in 1920, in the first instance, when it acquired a controlling interest in a company known as the Compressed Carbonic Company.

Later, in August, 1929, Airco organized the Pure Carbonic Company of America, and acquired a controlling interest in that company.

In September, 1929, Pure Carbonic Company of America organized Pure Carbonic, Inc., of Delaware, and the Pure Carbonic Company of America held all the capital stock of Pure Carbonic, Inc.

Now we come again to the same pattern repeated in this [fol. 36-22] third branch of the operations of Airco. On October 1, 1929, Pure Carbonic Company of America entered into an operating agreement with Pure Carbonic, Inc., under which it employed Pure Carbonic to manage and operate its plants and sell their output.

Later Pure Carbonic of America and Airco acquired other companies, including the American Dry Ice Company, and it acquired those companies again by payment of its own cash or by the issuance of its capital stock. And certain of these fixed and other assets were transferred to Pure Carbonic, Inc.

Then we move along to 1935, and in that year, Airco became the owner of the entire outstanding capital stock of Pure Carbonic Company of America. Up to that time it had merely had a controlling interest.

In July, 1936, Airco caused the dissolution of Pure Carbonic of America, and became the owner of all its assets.

Now, these assets of Pure Carbonic of America included the stock of its subsidiary, Pure Carbonic, Inc., together with the rights of Pure Carbonic Company of America, under the operating agreement of October 1, 1929, with Pure Carbonic, Inc. Again, the operating pattern of 1917 was followed.

And now and finally, the Wilson Welder and Metals Company. Of course, in the oxy-acetylene field, the original uses were known by the Gas Flame Welding and Cutting process. But Airco wished to make available to industry the most comprehensive engineering facilities and equipment in the field of welding and cutting, and, therefore, it expanded into the field of electric welding, and in January 1931, it acquired control of a company known as Wilson Welder and Metals.

In April, 1934, Airco acquired all the capital stock of that company, and again, the stock of that company was purchased by the payment of Airco's own cash and by the issuance of its own capital stock.

[fol. 36-23] In June, 1936, Airco, a sole stockholder of Wilson, caused it to make a distribution to Airco of all its plants and fixed assets in a partial liquidation.

Thereafter, in August, 1936, Airco entered into another operating agreement with Wilson Welder under which it employed Wilson Welder to manage and operate electric welding and cutting equipment plants and to sell their output.

Airco transferred to Wilson Welder all the plants, and all the other fixed assets used by Wilson in performing this operating agreement between them. Once again the operating pattern established 20 years before was followed.

Now, in our proof here we shall endeavor to show, against this highly integrated background of development, that in their operation, both during and prior—long prior to 1938—the three Petitioners and Wilson Welder functioned as incorporated branches, divisions, or departments of Airco.

I think the rather brief resume of Airco's expansion which I have endeavored to give shows in a summary way, at least, that Airco developed logically and reasonably as an integrated industrial unit in the broad field of gas manufacturing and sales.

In our proof we shall go further and we will show that during and prior to 1938 these four subsidiaries in their actual internal operations did function as incorporated branches, divisions, or departments of Airco.

We shall show that they could not function as they did function and be anything, in our view, but an integral part of this industrial whole.

Now, a few of the more significant facts which our evidence will establish, I may state in substance at this point.

I have already touched upon the situation as it appears from the operating agreements. I need not mention that further at this time. In addition, we shall show that, as [fol. 36,24] to company offices, the general offices or office was maintained by Airco and the four subsidiaries at 60 East 42nd Street.

We shall further show that each of the officers of Airco and the four subsidiaries with one or two inconsequential exceptions had his office in the general offices of the company.

As to executive management, we shall show that in 1938 and prior Airco directed all the policies and the management of the three Petitioners and Wilson Welder through the substantial identity of its executive officers and directors were the officers and directors of the subsidiary companies.

As to the branches of the Airco business, we shall show that the business was divided into six main branches, and that each of these branches was directed by five vice presidents of Airco and one assistant vice president of Airco. These branches, in order that they may appear in summary form in the record, I shall say at this point were the corporate, operations, sales, distribution, financial, and research. Each of these branches, we shall show, performed services for all of these subsidiary companies. I might also say—if I may speak loosely—indiscriminately.

As to general accounting, we shall show that the general accounting department had charge of all accounting for Airco and for each of the four subsidiaries. That uniform methods of accounting were employed. That separate books of account were kept for each subsidiary and for Airco. That the general ledger and control records were kept for each of those companies at the New York office. That the employees of this general accounting de-

partment—both in the New York office and in the field offices—performed services for Airco and for the four subsidiaries, and that no individual in this general accounting department was identified with any particular company.

[fol. 36-25] As to the important matter of credits and collections, we shall show that this section of the treasury department of Airco was in charge of a general credit manager, who performed credit and collection functions for Airco and for the four subsidiaries.

As to the matter of bank accounts, the financial control, we shall show that although each of the subsidiaries had a separate bank account, the funds in these accounts were subject to withdrawal by the officers of the Airco and were under the complete domination and control of Airco, and that the bank accounts of the four subsidiaries, in actual fact and operation, were treated by Airco as its own.

As to the matter of expenditures, we shall show that all expenditures by any subsidiary in excess of $500 were subject to the express approval of the Chairman of Airco and of the Board of Directors of Airco.

As to the working capital which was covered by a provision of the operating agreement, we shall show that Airco provided, under the operating agreements, and furnished, the initial capital of each subsidiary company; that, in practice, Airco supplied additional working capital by permitting the subsidiary to retain a minimum balance of Airco's own funds in the subsidiary's bank account, and that the amount of the minimum balance was determined by the executive officers of Airco.

As to purchases, we shall show that purchases for each of the four subsidiaries from outside vendors were made only upon orders issued by the general purchasing agent of Airco except for emergency purchases under $50.

As to sales, our proof will show that the sales of products of all plants, all four subsidiaries were under the supervision of two vice presidents of Airco; that products, in many cases, were transferred from one subsidiary to another subsidiary, on a basis approximating cost and that such transfers and purchases by one subsidiary for another, from third parties, were reflected on the accounting [fol. 36-26] records through intercompany accounts and without the passage of any cash.

And, finally, we shall show that the Airco organization maintained a research department, well equipped, with laboratories, and a large staff of technicians, and that department functioned in the scientific field with respect to all phases of the business of Airco and its four subsidiaries. These are but a few of the important phases of proof which we endeavor to establish.

Now, on this state of facts, how did Airco and its four subsidiaries file their Federal returns for the taxable year 1938? The Federal tax returns of Airco and its four subsidiaries were prepared in accordance with each of these operating agreements and in accordance with the accounts of the companies. The returns of the four subsidiaries showed only their income, that is, the compensation received from Airco, under the operating agreements, and there was attached to the returns—and there had been attached in prior years—schedules which showed and explained in full the operations of the e subsidiaries.

In the return of Airco, the parent company, the operations of the subsidiaries were reported, we say, correctly, as Airco's own operations, and the compensation paid by Airco to the subsidiaries, under the operating agreements, were deducted on Airco's return as an expense of Airco under the heading of "Other Deductions."

Now, a little more about Airco's return. First, as to the income and declared value excess profits tax return. On this return, Airco included the results of operations of the three Petitioners and Wilson Welder. In its original return it showed adjusted net income of about $4,204,000 and an income tax liability of about $639,000.

Then a comparatively minor correction necessitated the filing of an amended return, and the amended return showed an adjusted net income of about $4,227,000 and an income tax liability of about $643,000.

[fol. 36-27] That sum, $643,000, Airco paid to the Government.

Now, as to Airco's capital stock tax return for the year ended June 30, 1938, on this return Airco declared a capital stock value of $72,981,000. Obviously it declared that large amount so that 10 percent of that amount would offset the combined estimated income of itself and its four subsidiaries, and thus eliminate any liability to Airco for declared value excess profits tax.

And on this declaration of value Airco paid a capital stock tax—a very substantial one—$72,981.

In the computation of its declared value excess profits tax liability, Airco, of course, deducted 10 percent of the declared value of its capital stock—the declaration had been $72,981,000—that is, it took a credit or an allowance of $7,298,100, and of course, since that amount, $7,298,100, substantially exceeded Airco's net income, which was just a little in excess of four million dollars, Airco's return showed no liability for declared value excess profits tax.

Now, the returns of the three Petitioners for 1938:

The three Petitioners and Wilson Welder filed separate income and declared value excess profits tax returns. Each of them showed as its only income the compensation received from Airco under its respective operating agreement; and the respective amounts of their income and income tax liability, and of their declared value excess profits tax, I should like, very briefly, to summarize, because it involves the three companies, and I should like to keep the picture clear.

The Sales Company showed an income of $750 on which it paid an income tax of $93 approximately. It had no declared value excess profits tax.

The Carbide Corporation showed an income on its return of $300 on which it paid an income tax of about $37, and showed no declared value excess profits tax.

Pure Carbonic showed an income of $300 on which it [fol. 36-28] paid an income tax of $37, and showed no declared value excess profits tax.

Wilson Welder showed an income of $600 on which it paid an income tax of $75, and it showed no declared value excess profits tax.

Now, as to the capital stock tax returns for the year ended June 30, 1938, of the three Petitioners and Wilson Welder. They declared capital stock values, and Airco paid, for their respective accounts, capital stock taxes as follows:—again I will just summarize—

The Sales Company, declared a value of its capital stock of $7,999. It paid a capital stock tax of $8, and 10 percent of that declared value, in the case of the Sales Company was $799.90. Its income was $750.

Similarly, the Carbide Corporation declared a value of $3,999 and paid a capital stock tax of $4, 10 percent of the declared value was $399.90. Its income was $300.

The figures for Pure Carbonic are exactly the same as those for the Carbide Corporation.

Wilson Welder declared a value of $6,999, paid a capital stock tax of $7. 10 percent of the declared value was $699.90. Its actual income was $600.

Obviously, the four subsidiaries declared capital stock values in such amounts that 10 percent of the declared value of their stock did exceed the amount of their compensation under the operating contracts. Thus they also eliminated any declared value excess profits tax liability on their account, and their returns reflected no such liability.

Now, what were the adjustments made by the Commissioner in our 1938 returns?

The Commissioner took the position, against this background of facts which I have endeavored to delineate, that these operating contracts between Airco and the four subsidiaries, which had always been fully disclosed and of long standing, should be utterly disregarded. He said [fol. 36-29] they should be ignored. And he asserted that the proceeds of the operations of each of the four subsidiaries belonged to the subsidiaries and not to Airco and were taxable only to the subsidiaries. And on that basis he eliminated from Airco's return, $4,263,000 credited to Airco by the four subsidiaries under their operating agreements, and the Commissioner correspondingly increased the taxable income reported by the three Petitioners to the extent of $4,263,000.

He reported their additional net taxable income, after certain deductions for portions of Airco's expenses, to be as follows:

He reported a net income for the Sales Company of $3,034,000.

For the National Carbide Corporation, of about $842,000.

For Pure Carbonic, about $149,000.

And the aggregate deficiencies—alleged deficiencies for income and excess profits tax—were $1,066,000, broken down as follows:

About $803,000 for the Sales Company; $223,000 for the Carbide Corporation; $39,000 for Pure Carbonic.

Now, it was, according to our views, your Honor, an ingenious disposition, but the ingenuity didn't stop there.

The Commissioner, in addition, made corresponding, arbitrary adjustments, as we see it, in the income of Airco.

He found that Airco's net income was about $2,892,000, and he reported an over-assessment of Airco in the amount of $545,000, and then he took the position that this over-assessment, $545,000, was barred by the statute of limitations.

Just a word about Wilson Welder. The Commissioner determined no deficiency against Wilson Welder. The result of its operation for the taxable year was a net loss of about $89,000. In fact, he did determine an over-assessment in income tax against Wilson Welder of $75.

[fol. 36-30] Then, the Commissioner went on and he applied Section 45 of the Revenue Act of 1938 to the apportionment of expenses. These expenses of Airco had totaled approximately $415,000, and he apportioned them between Airco and the four subsidiaries—about $12,000 to Airco; and $403,000 among the four subsidiaries.

Now, I think it is significant—at least in passing—that in this purported allocation of expenses and deductions pursuant to Section 45, the Commissioner made no allocation or apportionment of the credit or allowance of the item of $7,298,100. That amount, your Honor will recall, represented 10 percent of the declared value of Airco's capital stock, taken as a credit or an allowance by Airco in the computation of its declared value excess profits tax liability.

Had that time been allocated as fairness would have dictated, the alleged deficiency in declared value excess profits tax of $483,000 would have been entirely wiped out.

Now, there are two minor alleged deficiencies against Pure Carbonic. They are of lesser and relatively little importance. I will say just a word about them later.

In other words, as we see it, the situation boils down to this: the Commissioner determined that an arbitrary addition of income should be made to the four subsidiaries, although Airco had duly reported and paid taxes on their income pursuant to the operating contracts, in accordance with a business system based upon convenience and necessity, which had been in force for over 20 years. He determined that not only should the operating companies be compelled to pay $1,066,000 in additional income and declared value excess profits tax on the same income on which Airco had already paid taxes, but he determined that no offset or refund of the over-assessment of $545,000 should be made to Airco because of the bar of the statute.

[fol. 36-31] What were the reasons assigned by the Commissioner for this determination? And I think the reports

show almost no explanation of a convincing kind for this recommendation which we deem unjust and unconscionable. The reports state only that consolidated returns were not permitted; that each subsidiary must report and pay taxes on its own income, and in the allocation of expenses, the Commissioner invoked the authority of Section 45.

Our reply to those purported explanations may be stated in summary form in this way: to the suggestion that the returns of Airco and its subsidiaries amounted to consolidated returns, we say that Airco did not attempt to file a consolidated return. Each company filed its own return, showed its own income under its own operating contract.

As to Section 45, which merely authorizes the Commissioner to allocate gross income and deductions in order to prevent tax evasion or more clearly to reflect income, we say there can be no question here of any tax evasion or attempted tax evasion.

And as to the addition of income to the subsidiaries by the Commissioner, we think that purported disposition or distribution clearly distorts the income instead of reflecting it.

Now, in this opening—and I realize it has been rather long, but I think we are covering a lot of necessary corporate history and development here—we shall not attempt to discuss or argue the applicable authorities. I should like, however, to direct your Honor's attention to one case with which I have no doubt he is already rather familiar: Customs Casing Company. I will give you the citation just a little bit later.

The facts in that case were very strikingly similar to the facts in the present case. There the subsidiaries involved were held to be incorporated departments, divisions, [fol. 36-32] or branches, or agents of the parent company. There they were operating, as here, under express operating contracts between the parent and the subsidiaries. There also the facts relating to the internal operations and management of the companies were practically the same as in the present case, except that, in my opinion, the facts in our case are even more persuasive than they were in that case.

And in that case, Customs Casing, Judge Kern overruled the determination of deficiency and said in language which I think has a singular applicability here: "If we disregard the corporate entities, then clearly the losses of

the subsidiary agents, absorbed and defrayed by Hygrade (the parent) would be deductible by it as its own. While if we consider the subsidiary agents as separate corporate entities, we must give effect to the agency contracts executed between them and Hygrade and come to the conclusion indicated above, that Hygrade is entitled to the net receipts of the subsidiary accounts and conversely is entitled to deduct any losses incurred by the subsidiary accounts pursuant to the agency contract which Hygrade was obligated to pay and which, in fact, it did pay."

Now, in the Customs Casing case, the only question—at least on this phase of the case—was the right of the parent company to deduct an operating loss of a subsidiary which had been assumed by the parent under an operating contract.

The question presented in the present case does not essentially involve a taxpayer's right to deduct the operating loss of a subsidiary. Here the huge additional taxes claimed result from an arbitrary addition to the income of the subsidiary companies, of a portion of the income turned over by them to Airco, and reported by Airco in accordance with the operating contracts.

In short, your Honor, we find no legal authority for [fol. 36-33] thus taxing subsidiary companies on income which, pursuant to contract, had been paid over to and reported by a parent company. We submit that the claims for these additional taxes are neither supportable on authority or on principle, and, in our opinion, this shapes up as patently unconscionable, and we ask that this Court find there are no deficiencies in the Petitioner's income and declared value excess profits taxes for the year 1938.

The Court: Mr. Maddox, do you have a statement for the Commissioner?

First of all, you, Mr. Wilson, you mentioned two issues that were not covered by your general statement.

Mr. Wilson: Oh, yes. I would like simply to say about that that on its original return Airco took a deduction of $55,934.09 as amortization of contract rights, and later, as I have indicated, Airco filed an amended return and reduced this deduction by the sum of about $23,000 to $32,000. Respondent disallowed, as against Pure Carbonic, the difference of $23,000.

It is the position of Pure Carbonic that this adjustment was properly made with Airco, its principal, because all the income, as I have indicated, produced by the operation of

Pure Carbonic, belonged to Airco with the exception of the compensation under the operating contracts, and the amount of this deduction having been adjusted with the Commissioner is no longer in dispute and Airco has paid the additional tax resulting from that adjustment.

Now, what company, whether Airco or Pure Carbonic, is ultimately entitled to avail itself of the conceded amount of the deduction, will necessarily be resolved by the determination of the principal issue in this case, and, therefore, as we see it, the petitioner need not and will not offer any evidence relating to this deduction, since the amount of the deduction is no longer in dispute.

Then, there was one other item, also relating to Pure [fol. 36-34] Carbonic. On the original and amended returns filed by Airco, a deduction of $46,000 was taken. That consisted of two portions: $35,000 which was paid in settlement of certain legal actions, and about $11,000 paid in attorney fees in connection with those actions. The Respondent has disallowed the deduction of $46,000 as against Pure Carbonic on the ground that it was a capital expenditure.

The position of the Petitioner Pure Carbonic, is that this deduction was proper on the merits, and that it should be allowed to Airco, its principal, because all the income produced by operations of Pure Carbonic belonged to Airco.

There again the same question arises in substance. What company, whether Airco or Pure Carbonic, is ultimately entitled to avail itself of that deduction, and that must also necessarily be resolved by the determination of the principal issue in the case.

If the position of the Petitioner that substantially all the income produced by it belongs to Airco be sustained, then the deduction, if any be allowed, may be taken by Airco. In that event, however, the propriety of the deduction on the merits cannot be determined in this proceeding, since Airco is not a Petitioner in this proceeding.

If, on the other hand, the position of the Respondent be sustained, that substantially all the income produced by the Petitioner belongs to the Petitioner, then, this deduction could only be taken by the Petitioner and not by Airco. However, we do not wish to complicate unnecessarily the trial of the principal issue, and the Petitioner prefers not to offer in this proceeding any proof relating to the merits of what, after all, is a relatively minor deduction, and for

the present it is content to rest the determination as to this deduction solely on the determination of the principal issue here involved.

I think our attitude on these points will tend to simplify the presentation of the real issue here.

The Court: Mr. Maddox.

[fol. 36-35] OPENING STATEMENT ON BEHALF OF RESPONDENT

BY MR. MADDOX

Mr. Maddox: I have just a brief statement. As your Honor no doubt observed from the opening statement of Mr. Wilson, the question here is the effect of these contracts between the various companies, the subsidiary companies and the parent company.

The Respondent's position is that those contracts, whatever their effect, do not bind the taxing authorities, that they have no substance and have no validity, and the fact that they are of long standing is of no particular interest.

As your Honor no doubt knows, in the year 1917 consolidated returns were permitted for excess profits tax purposes. They were denied for income tax purposes. And since 1917 and up to 1936, consolidated returns were required. So that these contracts entered into the taxing question not at all. There was consolidation of all the companies. It didn't make any difference whose income it was. It all went in, and there was a consolidated figure and a consolidated tax.

Now, beginning in 1936 and through the taxable year here, 1938, consolidated returns were only permitted with reference to railroad companies, so that the contracts apparently came to the fore at this particular time.

Now, the Respondent's position is this, briefly: that these contracts serve no business purpose. I have not yet heard Mr. Wilson mention any real business purpose served by these companies.

Now, Airco, or Air Reduction Company, the parent company, organized these subsidiaries, and put in the possession of these subsidiaries substantial assets—I mean assets running into millions of dollars, tens of millions of dollars. Those assets were operated in the ordinary [fol. 36-36] business way. They were operated by the subsidiaries. The subsidiary in each case had books of account which recorded those operations. The figures that

the Respondent has used are the figures of those operations of each individual subsidiary.

Now, it happened that there was an over-all executive expense, executive and administrative expense that was allocated under Section 45 to the various subsidiaries. The Respondent says that the fact that there is an over-assessment due Air Reduction Company has nothing to do with it. The Respondent is not bound by Petitioners' election to declare small values for the capital stock for the subsidiaries. That is unfortunate, I suppose, but the question here for your Honor to decide is what is the effect of this contract on taxes. Respondent says it has no effect. Petitioner says it has every effect, to secure the approval of your Honor and for the method they pursued.

With reference to the last issue that Mr. Wilson mentioned, that is, the amounts paid in settlement of lawsuits, I don't quite understand the position he is taking on that. He says that that is to depend on what your Honor's decision will be on the main issue. It still is the issue here as to whether the amount represents an expense or a capital expenditure.

(Cert. tr., p. 90.)

The Court: I understood him to concede that issue, if our court should sustain the Commissioner on the main issue.

Mr. Wilson: That is correct, your Honor.

Mr. Maddox: You concede the disallowance of the deduction if the court concedes the Respondent is correct on the main issue?

Mr. Wilson: Yes, so far as this Petitioner is concerned. [fol. 36-37] The Court: That is what I understood. Of course, we do not have the Air Reduction Company, Inc., before us.

Mr. Maddox: That is correct.

* * * * * * *

(Cert. tr., pp. 90-91.)

You may proceed with the evidence, Mr. Wilson.

Mr. Wilson: Your Honor, there was one slight matter I noticed in Mr. Maddox's opening. I believe he stated that consolidated returns were permitted up through 1935.

My understanding is that they were permitted up through 1933 and discontinued thereafter up to and beyond the taxable year, except as to railroads. It is just a question of the year, Mr. Maddox.

Mr. Maddox: They were required, I said, beginning with the year 1936, or to the year 1936.

Mr. Wilson: My understanding is that that is in error. It was through the year 1933.

Mr. Maddox: Well, that is a matter of law. The 1934 Act was the last.

The Court: I remember generally when the law was changed, but it would be difficult for me to say at the moment just exactly when it was, so we will determine that, of course.

Mr. Wilson: Yes.

. . . . . .

[fol. 38] EXCERPTS FROM TRANSCRIPT OF TESTIMONY

. . . . . .

(Tr. 91-208.)

M. W. RANDALL, a witness on behalf of the Petitioner, was duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Mr. Randall, do you occupy any position at the present time with Air Reduction Company, Inc.?

A: Since December 31, 1944, I was retired and returned as a consultant.

Q. May I just inject a word of caution at this joint? Will you talk up a little more loudly because his Honor sits a little distance from you and I want him to hear everything you say.

You say you retired when?

A. December 31, 1944.

Q. And since that time you have occupied what position?

A. I have been retained as a consultant.

Q. Now, at the time of your retirement, what position did you hold with Airco—that is, Air Reduction Company, Inc., and with the four subsidiary companies?

[fol. 39] A. I was a vice president of Airco, Inc.; and a vice president of all the subsidiaries, the four subsidiaries, and a director of Pure Carbonic.

Q. How long, in all, has your connection with the Airco organization extended?

A. Since March 1, approximately, 1916.

Q. Right up through the date of your retirement?

A. Yes, sir.

Q. Do you recall when, approximately, Airco was incorporated?

A. November 26, 1915.

Q. And is Air Reduction Company, Inc., sometimes familiarly known as Air Reduction or Airco?

A. Yes, sir.

Q. And are the products manufactured by Air Reduction and its subsidiaries sometimes familiarly referred to as Airco products?

A. Yes.

Q. I show you this pamphlet and ask you if that is a copy of the certificate of incorporation of Air Reduction Company, Inc?

A. It is.

Mr. Wilson: I will offer that pamphlet in evidence.

Mr. Maddox: I would like to call your Honor's attention to one point here. We have the year 1938 under consideration. This is the printed copy of certificate of incorporation of 1915 with amendments to April 8, 1936. I object on the ground that is hasn't been shown that these are the minutes in force and effect in 1938.

Mr. Wilson: I understand, your Honor, that this certificate, with the amendments shown therein, were in full force and effect throughout 1938, and that there have been no amendments subsequent to April, 1936.

The Court: Very well. It will be received as Petitioner's Exhibit No. 1. Objection is overruled.

(The printed copy of certificate of incorporation with amendments to April 8, 1936 was received in evidence as Petitioner's Exhibit No. 1.)

[fol. 40] By Mr. Wilson:

Q. Now, Mr. Randall, what was, very briefly, the primary purpose of Air Reduction Company?

A. Well, Air Reduction Company was organized primarily for the purpose of producing oxygen from the air, and I suppose at the time there was some little thought given—but not much—to the other gases of air. Oxygen was the big factor.

Q. And was the oxygen, which was produced at the outset by Air Reduction Company, primarily for use together with acetylene in what is known as the oxy-acetylene process?

A. Yes.

Q. Just so that we will have a realistic picture of things, I would like to bring out a few points about the extraction of gas from air. Is the process of extraction of oxygen and other gases from air, which was employed by Air Reduction Company, commonly known as the fractional distillation of liquid air?

A. It is.

Q. And is the process, in brief, this, that air is liquefied under pressure and then at different sub-zero temperatures, the various gases are distilled off?

A. That is correct, substantially.

Q. Now, in addition to the gas oxygen, what other gases are extracted from air in accordance with this general process?

A. Well, of course, there is nitrogen, and then the rare gases, argon, neon, zeon, krypton, and helium are also boiled off in the course of this process.

Q. Now, because most of us have forgotten what we should remember from school days, is it an approximately correct fact to say that 70 percent of air is made up of oxygen, and about 28 percent of nitrogen?

A. That is approximately right, I think.

Q. And that these rare gases comprise less than about 1 percent of the total of air?

A. Yes, it is a very small percentage.

Q. And these rare gases——

Mr. Wilson: I realize, Mr. Maddox, I am leading a little at this point, but it is just background.

[fol. 41] By Mr. Wilson:

Q. Are these rare gases to which we have referred known as argon, neon, zeon, krypton, and helium?

A. That is correct.

Q. Just tell us in a word what the primary uses of nitrogen are, as produced by Air Reduction Company?

A. Well, I am not as well qualified as some of our technicians to answer that question, but I will do my best to answer it. There was a time when nitrogen was used *by* quite a lot in the production of electrical equipment. I think one of the present major uses is the canning of perishable food stuffs.

Q. Well, let me ask you this, from the point of view of scientific interest: isn't it a fact that electric bulbs were originally made with a vacuum?

A. I don't know. I think they were.

Q. You don't know. All right. My understanding is that they were and that later nitrogen was injected and created an increase of efficiency of about 20 or 25 percent. However, we will move along.

Now, from the beginning, did Air Reduction Company also manufacture acetylene gas?

A. Well, I don't think exactly at the beginning, but it had to get acetylene gas. It was one of its musts, that it should get acetylene gas soon after it began to sell oxygen. So I think it must have followed very closely after the entry of Airco into business.

Q. Yes. Within the space of approximately how much time?

A. Oh, a few months, a very few months.

Q. Yes. And are oxygen acetylene used in what I have just described as a rather companionate way in this oxy-acetylene welding process?

A. Yes.

Q. Did Air Reduction Company also manufacture hydrogen?

A. Yes, but not in connection with the process that we have been discussing. Hydrogen is produced by electrolysis of water.

Q. In other words, am I correct in saying that although there is some hydrogen present in air, it is not commercially practicable to extract it in that way?

[fol. 42] A. That is right.

Q. Also, did Air Reduction Company manufacture certain apparatus for use in the oxy-acetylene process?

A. Yes, there was an urgent need felt after we got into the oxygen business, particularly for hand welding and

cutting torches, so we did go into the manufacture of equipment.

Q. Did there come a time, in or about the year 1921, when Air Reduction Company began the manufacture of its own calcium carbide?

A. Yes.

Q. Just tell us about that in your own way, in summary form.

A. Well, Airco, as I said, needed acetylene, and in order to make its own acetylene, it had to have calcium carbide, and it acquired an interest, in 1920, I think it was, in the National Carbide Corporation of Virginia. Over a period of time—shall I go on with the story?

Q. Go right ahead.

A. Over a period of time—I think it was seven or eight years—Air Reduction finally got control of that Virginia corporation. Meanwhile the Virginia Corporation had organized a sales company, and it had given one of our agency agreements to the sales company.

Q. Just pause at that point for the moment. The National Carbide Corporation of Virginia had been operating plants of its own, had it?

A. Two, I think. One at Ivanhoe, Virginia, and one at Keokuk, Iowa.

Q. How, very briefly and non-scientifically, do you transform calcium carbide into acetylene?

A. All I know about it is that you fuse coke and limestone in an electric furnace.

Q. And you make calcium carbide?

A. That is right.

Q. How is calcium carbide turned into acetylene?

A. By the action of water on the calcium carbide.

Q. Let us now move along into the carbonic gas field. Is it true that—did there come a time when Air Reduction [fol. 43] Company entered the field of manufacturing and distributing carbon dioxide?

A. Yes.

Q. Approximately when did it first enter that field?

A. I think it was 1921 that it got an interest in a small company called the Compressed Carbonic Company.

Q. Now, does carbon dioxide come in several forms, that is, in gaseous and liquid form, and also in solid form?

A. Well, the gaseous and liquid form is almost interchangeable.

Q. Yes.

A. The solid form, of course, is entirely different, and it does come in those forms.

Q. And in gaseous and liquid form, is it commonly known as carbonic acid gas or carbonic gas?

A. Correct.

Q. And in solid form is it commonly known as dry ice?

A. Correct.

Q. And is it a fact that the primary use of carbonic gas is in the carbonation of beverages for human consumption?

A. Yes, that is the basic use.

Q. And that the chief use of dry ice is for refrigeration purposes?

A. Refrigeration purposes and also, nowadays, carbonation.

Q. Yes. Now, at a later time did Air Reduction Company enter the field of electric welding as distinguished from gas flame welding?

A. Yes, sir.

Q. Approximately when did that occur?

A. I am a little vague on that date. I know that the Wilson Welder and Metals Company, which was the beginning of Airco's participation in electric welding, was organized in 1915, but I think it was probably 1920 or 1921 that Airco got an interest in that company.

Q. You have told us that Wilson Welder and Metals, you understand, was organized about the year 1915.

A. Yes, I think that is my recollection of it, yes.

Q. Does it refresh your recollection as to the time when Airco entered the field, if I mention the date as being 1931?

[fol. 44] A. Yes, that is right. 1931.

Q. Was it about 1931?

A. About 1931, yes.

Q. In 1938, the year which we are primarily interested in here, the year that is primarily involved here, was Air Reduction Company engaged in four branches or fields of operation?

A. That is correct.

Mr. Maddox: I object on the ground that that calls for a conclusion of the witness.

Mr. Wilson: I will withdraw the question.

By Mr. Wilson:

Q. In 1938, in what fields of operation was Air Reduction Company engaged?

A. Well, the first field of operation was centered around the oxy-acetylene process and business was carried on by Air Reduction Sales Company.

Q. And what gases was it extracting from air during that year and prior thereto?

A. Well, I suppose, in a small way, all of the gases, but not commercially in 1938, in some of the rarer gases.

Q. Well, it was extracting in a big way, wasn't it, the oxygen and nitrogen?

A. Oh, yes, oxygen, nitrogen, argon.

Q. And it was also extracting these so-called rare gases which we have enumerated?

A. Yes.

Q. Which constitute less than 1 percent of air?

A. Yes.

Q. And are these rare gases a comparatively recent development in the reduction of air process?

A. Yes, comparatively so.

Q. At least in a commercial way; is that right?

A. Right.

Q. By the way, do you know whether or not those rare gases are used principally in fluorescent lighting?

A. Yes, fluorescent tubes.

Q. Yes. Now, in 1938, what other fields was Air Reduction Company engaged in? Other than the reducing of the gaseous constituents of air?

[fol. 45] A. They were engaged in the calcium carbide business.

Q. What were they doing in that connection?

A. Operating the plants at Ivanhoe and Keokuk.

Q. And were they producing acetylene from the calcium carbide?

A. Yes.

Q. And what about apparatus and equipment? Was Air Reduction engaged in the manufacture and distribution of those in 1938?

A. Yes, sir.

Q. And in 1938, the National Carbide Corporation was engaged in operating in one of these fields; is that right?

A. That is correct.

Q. And what was its distinctive field of operation?

A. National Carbide?

Q. Yes.

A. Production of calcium carbide.

Q. And do you know how it disposed, in general, of its product, calcium carbide? And to whom, primarily?

A. Air Reduction took what it needed for the production of acetylene, and a part of the product left over was sold to the general trade.

Q. Yes. Are you able to tell us at this time approximately what percentage of calcium carbide was transferred by National Carbide Corporation to Air Reduction in 1938 for acetylene requirements?

A. I haven't the slightest idea.

Q. In 1938, was Air Reduction Company also engaged in the carbon dioxide field?

A. Carbon dioxide, both types.

Q. That is, liquid and gaseous and solid?

A. Liquid and gaseous, on the one hand, solid, on the other.

Q. In 1938, was Air Reduction Company also engaged in the manufacture, assembly and sale of electric welding machines?

A. Yes.

Q. And what company carried on that practice?

A. Wilson Welder and metals.

[fol. 46] Q. Now, Mr. Randall, will you tell us something about the organization of the Sales Company? I would like to direct your attention to that. First, when was it organized?

A. June, 1917, I believe.

Q. Do you recall that it was June, 1916?

A. I do, yes. I am sorry. 1916 is right.

Q. Maybe the confusion arises from the fact that I have the date as June 27, 1916.

A. Maybe so, I don't know. But I know it was shortly after the organization of the company.

Q. Yes. Now, from the period 1915 and thereafter up through 1919, did Air Reduction Company either form or acquire a number of subsidiary companies for the manufacture and distribution of gases?

A. Yes; 15 in all.

Mr. Maddox: How many in all?

The Witness: 15.

By Mr. Wilson:

Q. In the period from 1915 to 1919; is that right?

A. Yes, sir.

Q. And were these plants spread throughout the several states?

A. Very distinctly, yes, sir.

Q. When these plants, such of them as were organized, were organized, how was that matter handled, so far as their capital stock was concerned?

A. Air Reduction Company, Inc., organized the companies and paid the bills for organization.

Q. And in the cases where it acquired these companies, how were the assets of the companies paid for?

A. Either by issue of Airco stock or by cash, or possibly, in some cases, both.

Q. By whose cash? Payment of whose cash?

A. Airco's cash.

Q. And when any of these 15 subsidiaries were organized, who paid in the capital and took the stock?

A. Airco.

Q. Now, you have told us that in June, 1916—which would be, roughly, about seven months after Air Reduction [fol. 47] Company was organized—that the Sales Company was organized. Did Air Reduction Company at or about that time initiate a policy in connection with Sales Company and these 15 subsidiaries which we have mentioned?

A. Yes.

Q. What, in substance, was that policy?

A. An agency agreement was signed between Airco and Air Reduction Sales Company early in 1917, and as these companies that we have been discussing were acquired or organized, they, in turn, had a so-called agency agreement with Airco, or possibly it was an agency agreement procured by Airco and run into Air Reduction Sales Company.

Q. Yes. And what was done with the assets, fixed assets and other assets of these 15 subsidiary companies?

A. Well——

Mr. Maddox: At what time?

Mr. Wilson: In that period, as they were acquired or organized.

A. The physical assets were turned over by Airco to the organized or acquired companies.

By Mr. Wilson:

Q. What happened to the assets held by these 15 subsidiary companies after the organization of the Sales Company?

A. Oh, pardon me. The assets were turned back to the Sales Company.

Q. By the 15 companies?

A. At the direction of Airco, yes, sir.

Q. At the direction of Airco?

A. That is right.

Q. Now, Mr. Randall, I show you this photostatic copy of what purports to be an agreement dated March 1, 1917, between Air Reduction Company, and Air Reduction Sales Company, and ask you if you can identify that as a photostatic copy of the original agreement entered into on or about March 1, 1917?

A. Yes, I can so identify it.

Mr. Wilson: I will offer that agreement in evidence. I may say at this point that throughout we will probably want [fol. 48] to use photostatic copies, but the originals will always be available for check or comparison.

Mr. Maddox: I have no objection to the introduction of this contract except that this photostat does not present the signatures to the contract.

Mr. Wilson: May I simply say that this is a photostat of the original copy but in the photostating process the signatures in one or two cases appear not to have taken and they are a little bit vague in others, but we will produce the original copy and we will fill in the signatures for you and produce the originals. It is simply a technical matter of the photostating on that.

The Court: It will be received in evidence as Petitioner's Exhibit No. 2.

(The agreement dated March 1, 1917, was received in evidence as Petitioner's Exhibit No. 2.)

By Mr. Wilson:

Q. Now, Mr. Randall, I show you Petitioner's Exhibit No. 2, and call your attention particularly to Article III, Sub-

division 4. That provides that Airco agrees to procure for Sales (meaning Sales Company) such contracts with Airco's subsidiary or controlled companies as will enable Sales Company to exercise in each case the agency hereby created and will in each case constitute Sales Company the agent of such subsidiary or controlled company.

Are you familiar with that provision?

A. Yes, sir.

Q. Now, did Airco procure for the Sales Company various separate supplementary agreements with these 15 wholly-owned subsidiaries?

A. It did.

Q. I show you this photostatic copy of an agreement purporting to be an agreement dated March 1, 1917, between Air Reduction Sales, and Air Reduction Company of New Jersey, and I ask you first, if the Air Reduction Company of New Jersey was one of those companies comprised in the 15 subsidiaries we have been talking about?

A. It was.

[fol. 49] Q. Now, with reference to this photostat, can you identify that for us as one of these supplementary agreements that was entered into, pursuant to the provisions of Article III, Subdivision 4 of the contract of March 1, 1917?

A. Yes.

Mr. Wilson: I will offer that agreement in evidence.

Mr. Maddox: I have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 3.

(The agreement dated March 1, 1917, between Air Reduction Sales and Air Reduction Company of New Jersey was received in evidence as Petitioner's Exhibit No. 3.)

By Mr. Wilson:

Q. I now refer to Petitioner's Exhibit 3, Mr. Randall. Is this agreement between the Air Reduction Sales Company and the Air Reduction Company of New Jersey fairly typical of the agreements that were entered into between the Sales Company and others of those 15 subsidiaries?

A. Yes, I think it is exactly typical.

Mr. Wilson: May I say, Mr. Maddox, I would like to cut down the record by avoiding the putting in of duplicate voluminous documents. We have the similar agreements

relating to the Sales Company and the other 14 subsidiaries, and we will be prepared to put them in if you insist upon it; otherwise, we will make them available to you and you may examine them at your leisure. But I should like to avoid having to put them all in.

Mr. Maddox: I am familiar with them. I think it is substantially clear and correct that that is typical of the others.

The Court: If that be true there would certainly be no purpose served by introducing the others. It would just be encumbering the record.

Mr. Wilson: That is correct, Your Honor.

By Mr. Wilson:

Q. Now, in the period from about 1923 through 1936, were some of those 15 subsidiaries that we have been talking about dissolved?

[fol. 50] A. Well, they were all dissolved, I think, before the end of 1936.

Q. Yes. But some of them were dissolved, let us say, in the period between 1923 and 1935, is that right?

A. Probably so, yes. I don't know for sure.

Q. Do you recall that there were approximately 7 of them dissolved in that period, 1923 to 1935?

A. Yes, I remember the number seven.

Q. Do you remember that the five Superior Oxygen Companies, the Niagara Oxygen Corporation, and the Niagara Oxygen Company, Inc., were dissolved during that period?

A. Yes, sir.

Q. Then, in or about the month of May, 1936, the remainder of the 15 subsidiaries were dissolved, is that correct?

A. That is correct.

Q. Now when these subsidiaries were dissolved, what happened to the fixed assets of those 15 companies?

A. Well they were dissolved on Airco's instruction and the assets were taken over by the Air Reduction Sales Company.

Q. And were they subsequently used by the Sales Company in pursuance of the agreement of March 1, 1917?

A. Yes.

Q. Between Airco and the Sales Company?

A. That is correct.

Q. Now Mr. Randall, I should like to illustrate the method used in transferring the fixed assets of those 15 subsidiaries to the Sales Company. For that purpose, I ask you to ex-

amine, first; this paper which is a photostatic copy of a letter dated May 16, 1913, sent by Air Reduction Sales Company, Inc., and addressed to Air Reduction Company of New Jersey, and ask you if you can identify that as a photostat of the original letter which was one of the papers used in that transfer?

The Court: Did you say 1913?

Mr. Wilson: I shouldn't have, if I did; I meant 1936, your Honor. I beg your pardon.

The Witness: Yes, this — a familiar form. I can identify it.

By Mr. Wilson:

Q. Now I also hand you a photostatic copy of a paper which is marked "Bills of Sale", purported to have been [fol. 51] executed between the Air Reduction Company of New Jersey and the Air Reduction Company, Inc., under date of May 28, 1936, and ask you if you can identify that for us as another paper used in that same connection?

A. Yes, I can identify it.

Q. I also hand you a photostatic copy of a paper which appears to be a certificate of dissolution of Air Reduction Company of New Jersey, dated June 3, 1936, and ask you if you can identify that as a photostat of an original paper used in that same connection?

A. I can.

Mr. Wilson: I should like to offer the last three papers in evidence. I think it might be convenient if we offered them as one exhibit.

The Court: Yes, it would be better to attach them and receive them as one exhibit.

Mr. Maddox: I have no objection.

The Court: They will be received in evidence as Petitioner's Exhibit 4.

(The documents referred to above were received in evidence as Petitioner's Exhibit 4.)

By Mr. Wilson:

Q. Now, Mr. Randall, in connection with the transfer of the assets of those 15 subsidiaries, are these papers which have just been received in evidence a fairly typical set of papers in connection with that transfer?

A. Yes, sir.

Mr. Wilson: I would like to make the same suggestion, Mr. Maddox; in order to avoid encumbering the record unduly, we have the rest of the papers and you are at liberty to examine them, but I will not put them in.

Mr. Maddox: I understand that the witness just testified to that effect; however, I have no knowledge of it independently.

Mr. Wilson: I just wanted to let you know——

The Court: I think that is sufficient to establish, unless there is something to the contrary shown, that these documents were typical of other similar transactions.

[fol. 52] By Mr. Wilson:

Q. Now, Mr. Randall, in the period of approximately 1922 to 1936, did Air Reduction Company purchase the business and assets of 26 other companies?

A. Yes, 26.

Q. And how were the assets of those 26 companies paid for?

A. Stock of Airco, or cash of Airco, or maybe both in some instances.

Q. And after the purchase of the assets of those companies, what was done with the plant and equipment of those companies?

A. It was turned over to Air Reduction Sales Company in order to enable it to function under its agency agreement of 1917.

Q. I should now similarly like to illustrate the acquisition and transfer of the assets of those 26 companies, and for that purpose I would like to show you the documents which relate to the acquisition of the business and assets of the United Oxygen Manufacturing Company and also the U. G. I. Contracting Company. Were those companies included in this group of 26 companies?

A. They were.

Q. In that connection, I show you a set of photostats: the first is a set of the minutes of a special meeting of the Board of Directors of Air Reduction Company held June 29, 1927; the second document is a photostatic copy of a contract, dated July 6, 1927, between United Oxygen Manufacturing Company and the U. G. I. Contracting Company as sellers, and Air Reduction Company, Inc., as purchaser; the next

paper is what is called a Letter of Designation, dated July 8, 1927, from Air Reduction Company, Inc., to United Oxygen Manufacturing Company, and the U. G. I. Contracting Company; the next document is a letter, dated July 8, 1927, from the U. G. I. Contracting Company to the Air Reduction Company, Inc., enclosing deeds; the next document is a Bill of Sale, dated July 8, 1927, from United Oxygen Company to Air Reduction Sales Company; the next document in this group is a receipt for stock certificates dated July 8, 1927, from United Oxygen Manufacturing Company to Air Reduction Sales Company, Inc.; and [fol. 53] the last document is a receipt for stock certificates, dated July 8, 1927, from the U. G. I. Contracting Company to Air Reduction Sales Company, Inc. Will you just examine those photostats and tell us if you can identify them as photostatic copies of the originals which were used in connection with the acquisition and transfer of the plants of those companies referred to in the documents?

A. I can identify them all.

Mr. Wilson: I will offer that group of exhibits in evidence, your Honor; they are all connected and I think they should be offered as one exhibit.

Mr. Maddox: No objection.

The Court: They will be received in evidence as Petitioner's Exhibit 5.

(The documents described above were received in evidence as Petitioner's Exhibit No. 5.)

By Mr. Wilson:

Q. Referring to these papers comprising Petitioner's Exhibit 5, Mr. Randall, are those papers and documents typical of the papers which were used in connection with the acquisition of those 26 companies?

A. They are completely typical, yes.

Q. Now I should like to move on to the other field of operation, connected with the Calcium Carbide branch. You have already told us that Airco acquired a controlling interest in National Carbide Corporation of Virginia about in April, 1921, is that right?

A. That is right.

Q. And I think you have already mentioned that about a year later the National Carbide Corporation of Virginia

organized the National Carbide Sales Corporation under the laws of Delaware, is that right?

A. That is correct.

Q. And the Sales Corporation became a wholly-owned subsidiary of the National Carbide Corporation of Virginia, is that right?

A. Yes.

Q. I show you now this photostatic copy of what purports to be an agreement dated August 25, 1922, between the [fol. 54] National Carbide Corporation, a corporation of the State of Virginia, and the National Carbide Sales Corporation, a corporation of the State of Delaware, and ask you if you can identify that as a copy of the original agreement?

A. I can so identify it.

Mr. Wilson: I will offer that agreement in evidence, your Honor.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 6.

(The agreement dated August 25, 1922, was received in evidence as Petitioner's Exhibit 6.)

By Mr. Wilson:

Q. Mr. Randall, with reference to Petitioner's Exhibit 6, the agreement dated August 25, 1922, did that agreement provide that the Sales Company, the National Carbide Sales Company, should sell and distribute the products of National Carbide Corporation of Virginia?

A. It did, yes, sir.

Q. And did it acquire, among the assets of that corporation, the entire outstanding capital stock of the National Carbide Sales Corporation?

A. It did, yes, sir.

Q. And thereafter, did the National Carbide Sales Corporation continue to sell the output of the plants of the National Carbide Corporation of Virginia under the agreement which we have just marked in evidence, dated August 25, 1922?

A. Yes.

Q. Now, Mr. Randall, it is a fact, is it not, that in 1936, there were various corporate changes in connection with the National Carbide Corporation of Virginia, the National Carbide Sales Corporation of Delaware?

A. That is correct.

Q. In the form of dissolution and changes of name and transfer of assets and so on?

A. Yes, sir.

Q. Now I should like to show you a group of documents relating to the change which I have just outlined. They are photostatic copies of the following documents:

[fol. 55] Minutes of the regular meeting of the Board of Directors of Air Reduction Company held July 8, 1936, being the first document. The second document is a photostatic copy of a letter dated July 31, 1936, from Air Reduction Company, Inc., to National Carbide Corporation of Virginia. The next document is a letter dated July 31, 1936, from Air Reduction Company, Inc., to National Carbide Corporation. The next is a photostatic copy of a bill of sale dated July 31, 1936, from the National Carbide Corporation of Virginia to Air Reduction Company, Inc. The next is a bill of sale dated July 31, 1936, from National Carbide Corporation of Virginia, to National Carbide Sales Corporation. The next is a certificate of dissolution of the National Carbide Corporation of Virginia, dated July 31, 1936. The next is a certificate of an amendment of certificate of incorporation of National Carbide Sales Corporation, dated August 1, 1936. That is the last document.

Now, I ask you whether you can identify those as photostatic copies of the original documents which were used in effecting the changes that I have briefly described?

A. Yes, sir, I can identify them.

Mr. Wilson: I should like to offer those papers in evidence as one exhibit.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 7.

(The minutes of the meeting of the Board of Directors held July 8, 1936; letter dated July 31, 1936; letter dated July 31, 1936; two bills of sale dated July 31, 1936; certificate of dissolution dated July 31, 1936; certificate of amendment of certificate of incorporation dated August 1, 1936, were received in evidence as Petitioner's Exhibit No. 7.)

By Mr. Wilson:

Q. With reference to these documents, and the changes that they reflect with reference to the Carbide Corporations, Mr. Randall, I should like to ask you this, in order that we may understand the purport of these documents as we move along: was one of the changes that were effected in 1936 the change of name of the National Carbide Sales Corporation of Delaware to the National Carbide Corporation?

[fol. 56] A. Yes, sir.

Q. And prior to 1936 there had been this operating agreement between National Carbide Corporation of Virginia and National Carbide Sales Corporation of Delaware; is that correct?

A. That is right, yes.

Q. That is the agreement of August, 1922?

A. Yes.

Q. Under which the Sales Corporation was to market and sell the products of National Carbide Corporation; is that right?

A. Yes, sir.

Q. And in 1936, was the National Carbide Corporation of Virginia dissolved?

A. It was dissolved, yes.

Q. And thereafter did that operating agreement of August, 1922, run from Airco to National Carbide Sales, whose name was then changed to National Carbide Corporation?

A. Yes, that is right.

Q. Now, in 1936, was an agreement supplemental to that original agreement of August, 1922, entered into between Air Reduction Company and National Carbide Corporation, which was formerly the National Carbide Sales Corporation?

A. There was such an agreement.

Q. I show you this photostatic copy of an agreement made August 1, 1936, between Air Reduction, Inc., and National Carbide Corporation, formerly National Carbide Sales Corporation, and ask you if you can identify it as a photostatic copy of the original supplementary agreement.

A. Yes, I can so identify it.

Mr. Wilson: I will offer this agreement in evidence.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 8.

(The agreement dated August 1, 1936, was received in evidence as Petitioner's Exhibit No. 8.)

The Court: We will now recess until 2 o'clock p. m.

(Whereupon, at 12:30 o'clock p. m., the hearing recessed, to reconvene at 2 o'clock p. m.)

[fol. 57] Afternoon Session

The Court: You may proceed, Mr. Wilson.

Mr. Wilson: Please resume the witness stand, Mr. Randall.

M. W. RANDALL, the witness on the stand at the time of the recess, resumed the witness stand and testified further as follows:

Direct examination (cont'd).

By Mr. Wilson:

Q. Now, Mr. Randall, just before lunch, we had, I think, just about completed reference to the National Carbide Corporation. I would like now to talk about the Pure Carbonic, or the Carbonic—the carbon dioxide phase of Air Reduction Company, Inc.'s operations. Can you tell us approximately when Air Reduction Company entered into the carbon dioxide gas business?

A. I would say about 1921.

Q. Can you tell us something about the reasons which lay behind this next step into the gas field?

A. Well, Airco was accustomed to handling gas in drawn steel cylinders. This was another drawn steel cylinder business. The filling techniques were, at least, similar, and one gave a hint to the other. Air Reduction Company had a very large distribution department, a big fleet of trucks, and was used to handling cylinder gases with it, so that altogether, outside of its attractiveness as a business, it seemed to fit perfectly well into the Air Reduction Company program.

Q. This distribution department, did it maintain a large fleet of trucks?

A. Very large, as I said, yes.

Q. And the cylinders which, prior to that time, had been employed in the gas business other than carbon dioxide business, were cylinders used in the containing and transportation of oxygen and acetylene and some of these other gases; is that right?

A. Yes; oxygen, particularly. The carbon dioxide cylinder is practically the same as an oxygen cylinder. But not the same as an acetylene cylinder.

[fol. 58] Q. Can you tell us something about the relative weight of the cylinder which contains oxygen with the weight of the oxygen that it contains?

A. Well, a so-called 220-foot oxygen cylinder, meaning 220 cubic feet of oxygen compressed in the cylinder, weighs about 18 pounds.

Q. What weighs 18 pounds?

A. About 18 pounds. The cylinder itself weighs about 130 pounds. The value—do you want to know about the values?

Q. Yes.

A. The value of the cylinder is 15 or 16 dollars and the maximum value of the product is about $2.

Q. Yes. And, as I get it, the cylinder weighs about 130 pounds?

A. Empty.

Q. And the 220 cubic feet of gas weighs about 18 pounds?

A. 18 pounds, that is right.

Q. Would it be true to say, then, that the cylinders were heavy and costly, and the products which they contained was light and inexpensive?

A. Yes, the figures themselves demonstrate that.

Q. Now, in 1921, what was the initial step which Air Reduction Company took on entering the carbon dioxide fields?

A. They took an interest in a concern known as the Compressed Carbonic Company which operated in Baltimore.

Q. And did it acquire an interest in that company at that time?

A. Yes.

Q. Do you know whether or not that was a controlling interest?

A. I think it was from the beginning.

Q. Now, later on, was there a company formed, known as Pure Carbonic Company of America?

A. Yes. Compressed Carbonic Company and several other companies in the business formed the new company,

Compressed Carbonic Company of America, or whatever the name was.

Q. Pure Carbonic Company of America.

A. Yes, that is right.

[fol. 59] Q. Can you tell us approximately when that latter company was formed?

A. Well, I think about eight or nine years after the first venture of the company into the business.

Q. About 1929?

A. Something like that. 1929 or 1930.

Q. What interest, if any, did Air Reduction Company have in Pure Carbonic of America?

A. Well, it became the complete owner of Pure Carbonic of America, in the process of getting the companies together.

Q. Later on did Pure Carbonic Company of America organize Pure Carbonic, Inc.?

A. Yes; 1934, I think.

Q. Mr. Randall, I show you a copy of the certificate of incorporation of Pure Carbonic, Inc., and ask you to look at that and tell us, if you can, the accurate date.

A. Is this the first company?

Q. No; Pure Carbonic, Inc.

A. Yes. The first Pure Carbonic Company?

Q. Yes, Incorporated. Does that refresh your recollection as to the date?

A. Well, I have it in my mind that there were two Pure Carbonic, Incorporated, companies formed in the course of this development. Is that correct?

Q. Well, can you give us the date from that?

A. No, I can look at some notes that I have, if you will permit me.

Q. Anything that will refresh your recollection.

The Court: Yes, you may refresh your recollection, Mr. Randall.

A. My notes show that Pure Carbonic, Inc., was incorporated in Delaware in 1929.

By Mr. Wilson:

Q. Yes. Do you have the month there?

A. Yes. September 23, 1929.

Q. Yes. That would be just about a month after Pure Carbonic Company of America was organized?

A. That is right, yes.

[fol. 60] Q. Now, can you tell us what the relationship was between Pure Carbonic Company of America and Pure Carbonic, Inc.?

A. Pure Carbonic, Inc., was a wholly-owned subsidiary of Pure Carbonic Company of America.

Q. I show you this photostatic copy of a document which purports to be an agreement dated October 1, 1929, between Pure Carbonic Company of America and Pure Carbonic, Inc. And I ask you if you can identify that photostat as a photostat of the original agreement between those companies?

A. Yes, sir, I can identify it.

Mr. Wilson: I will offer that agreement in evidence.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 9.

(The agreement dated October 1, 1929, was received in evidence as Exhibit No. 9.

By Mr. Wilson:

Q. Now, were certain assets later transferred to Pure Carbonic, Inc., at the direction of Airco?

A. Yes, sir.

Q. Can you tell us what those assets were?

A. Well, all of the physical assets of Pure Carbonic of America.

Q. What kind of company was Pure Carbonic of America?

A. Well, it was a selling company, managing company, operating company. Oh, Pure Carbonic of America?

Q. Of America.

A. Oh, I beg your pardon. A holding company, that was, rather.

Q. Yes. You see to it that I make myself entirely clear, will you?

A. Yes. I was thinking of something else.

Q. Now, were certain assets transferred to Pure Carbonic, Inc., at the direction of Airco?

A. Yes.

Q. Can you tell us briefly what those assets were?

A. Well, I think they were plants and equipment, and I don't know what else.

[fol. 61] Q. How about the assets of Compressed Carbonic Company? Was anything done with those?

A. Why, I think they were absorbed in Pure Carbonic of America.

Q. Do you know anything in this connection about the assets of two other companies, Pure Carbonic of Illinois and Pure Carbonic of California?

A. They were ultimately a part of Pure Carbonic of America.

Q. Well, now, what happened to the assets of these companies, Compressed Carbonic and Pure Carbonic of California, and Pure Carbonic of Illinois? Do you recall?

A. No, I do not. Unless they were transferred to Pure Carbonic, Inc. I don't know what did become of them.

Q. I show you two sets of minutes. One a set of minutes of a special meeting of the Board of Directors of Air Reduction Sales Company held October 9, 1929, the other the minutes of a special meeting of the Board of Directors of Pure Carbonic Company of America held October 29, 1929. I ask you if you can identify those for us as photostatic copies of the original minutes.

A. Yes, sir, I can identify them.

Mr. Wilson: I will offer these minutes in evidence.

Mr. Maddox: May I ask the witness a question, your Honor?

The Court: Yes.

Mr. Maddox: Mr. Randall, how do you identify these documents? I notice here that the document, on its face, does not indicate that you were present at either one of these meetings, and they purport to be signed by R. B. Davidson, Secretary.

The Witness: Yes, I identified them by my recollection of the contents of the minutes or the letter or whatever it may be, and the signatures, with which I am thoroughly familiar.

Mr. Maddox: Do these papers correctly record your absence at these meetings? By failing to state that you were present?

The Witness: What is this meeting that we are discussing? A meeting of——

Mr. Maddox: Were you present at either one of these meetings? One purports to be a special meeting of the Board of Directors of Air Reduction Sales Company, Inc., [fol. 62] and the other a special meeting of the Board of Directors of Pure Carbonic of America.

The Witness: I wouldn't be at a meeting of the directors of Pure Carbonic of America. I might be present at a meeting of the directors of the Air Reduction Sales Company.

Mr. Maddox: Well, would you examine the other one and tell me whether you were at that meeting or not, that is, the meeting of the directors of the Air Reduction Sales Company?

The Witness: Apparently I was not.

Mr. Maddox: I object to the document as not correctly identified.

The Court: Objection is overruled. It will be admitted as Petitioner's Exhibit No. 10.

(The minutes dated October 9, 1929, and the minutes dated October 29, 1929, were received in evidence as Exhibit No. 10.)

Mr. Maddox: I note an exception.

* * * * * * *

By Mr. Wilson:

Q. Incidentally, Mr. Randall, and in connection with Mr. Maddox's questions of you, you were vice president of Air Reduction Company?

A. Yes.

Q. And did you have a general over-all supervision of what was known as the corporate branch of its operations?

A. I did, yes, sir.

Q. And was Mr. Davidson, the Secretary of the Company, under your general supervision?

A. Yes, sir.

Q. And is that the Mr. Davidson whose signature you have identified on those minutes?

A. Yes, sir.

Q. Now, Mr. Randall, from time to time did Pure Carbonic Company of America acquire the businesses and assets of other companies since 1929?

A. Very few. Three or four.

Q. Three or four?

A. Yes, sir.

Q. And in connection with the acquisition of the assets of those three or four companies, how were those assets paid for?

[fol. 63] A. Air Reduction Company put up the money and whatever other valuable considerations there were.

Q. Now, what other valuable considerations were there, do you know?

A. No, I don't.

Q. Now, do you know what happened to the assets of these three or four companies, what transfers were made of them, insofar as you recall?

A. If I remember correctly, Airco got the assets and held them, and then turned them over to Pure Carbonic, Inc., later.

Mr. Wilson: I should now like to put in some documents which illustrate these acquisitions by Pure Carbonic Company of America and their transfer to Pure Carbonic, Inc.

By Mr. Wilson:

Q. I should like to present these to you for identification. They are photostatic copies. The first of these documents is what purports to be a contract, dated February 9, 1930, between Pure Carbonic Company of America, and Natural Carbonic Ice Company, and Air Reduction Company, and U. S. Industrial Alcohol Company.

The next one is a photostatic copy of the minutes of a meeting of the Board of Directors of Pure Carbonic Company of America held February 27, 1930.

The next one a bill of sale dated March 28, 1930, from Natural Carbonic Ice Company, Inc.

The next one a certificate of dissolution of Natural Carbonic Gas Company dated June 26, 1930.

The next one a certificate of dissolution of Natural Carbonic Ice Company, dated July 29, 1930.

Will you examine those photostats and tell us whether they are photostatic copies of the original documents that were involved in those acquisitions and transfers?

A. I can identify them.

Mr. Wilson: I offer this group of documents in evidence.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 11.

[fol. 64] (The contract dated February 9, 1930, minutes of Board of Directors dated February 27, 1930, 2 bills of sale dated March 28, 1930, certificate of dissolution dated

June 26, 1930, certificate of dissolution dated July 29, 1930, were received in evidence as Petitioner's Exhibit No. 11.)

By Mr. Wilson:

Q. Mr. Randall, were these documents which are included in Petitioner's Exhibit 11 fairly typical of the documents used in connection with the acquisitions of companies by Pure Carbonic Company of America, and the transfer of their assets to Pure Carbonic, Inc.?

A. They are.

Q. Now, did there come a time when the Pure Carbonic Company of America purchased the business and assets of a company known as the American Dry Ice Corporation, and certain of its subsidiaries?

A. Yes, sir.

Q. Can you give us the approximate year of that?

A. With reference to my notes.

Q. That is all right.

A. April 6, 1934.

Q. 1934?

A. Yes, sir.

Q. Did Air Reduction Company subsequently acquire the entire outstanding capital stock of Pure Carbonic Company of America?

A. Yes, sir.

Q. And can you tell us when, approximately, that was?

A. Well, I think that was in 1934. I am not sure. My notes don't show it.

Q. Do you recall whether or not Airco later dissolved the Pure Carbonic Company of America?

A. Yes.

Q. Subsequent to the acquisition of all the capital stock?

A. Yes, it did.

Q. And on the dissolution of Pure Carbonic Company of America, did Airco acquire all of the capital stock of Pure Carbonic, Inc.?

[fol. 65] A. It did.

Q. And did it acquire, so far as you know, the rights of Pure Carbonic Company of America under the operating agreement of October 1, 1929, which has been put in evidence here?

A. It did.

Q. Now, I show you two documents in connection with the dissolution of Pure Carbonic Company of America. The first is a bill of sale dated July 30, 1936, from Pure Carbonic Company of America to Air Reduction, Inc., and the next is a certificate of dissolution of Pure Carbonic Company of America dated July 30, 1936. Can you identify those as photostats of the original documents for us?

A. I can so identify them.

Mr. Wilson: I offer those documents in evidence as one exhibit.

Mr. Maddox: No objection.

The Court: They will be received in evidence as Petitioner's Exhibit No. 12.

(The bill of sale dated July 30, 1936, and the certificate of dissolution dated July 30, 1936, were received in evidence as Petitioner's Exhibit No. 12.)

Mr. Wilson: May I simply say for the record, in order that the documentation may be clear, that the minutes of a regular meeting of directors of Air Reduction Company, Inc., held July 8, 1936, which relate to this dissolution, are already in evidence as the first exhibit, which is part of Exhibit 7.

The Court: Very well.

By Mr. Wilson:

Q. Now, in 1936, did Air Reduction Company dissolve Dry Ice, Inc.? Or do you recall? It is not easy to keep these all straight.

A. I am trying to think. I am not sure. My notes show that on July 31, 1936, they dissolved the 1934 Dry Ice Company.

Q. Were there various transfers of the assets from Dry Ice, Inc., to Pure Carbonic, Inc.?

A. There must have been.

Q. Well, do you recall whether there were?

A. I don't recall, no.

[fol. 66] Q. I show you various documents in connection with a transfer of assets, or transfers of assets from Dry Ice, Inc., to Pure Carbonic, Inc., and I will ask you if you can identify them as photostats of the original papers.

The first paper is a letter of direction dated July 31, 1936, from Air Reduction Company, Inc., to Dry Ice, Inc.

The next is a bill of sale dated July 31, 1936, from Dry Ice, Inc., to Air Reduction Company, Inc.

The next is a bill of sale dated July 31, 1936, from Dry Ice, Inc., Delaware, 1934, to Dry Ice, Inc., Delaware, 1936.

The next is a certificate of dissolution of Dry Ice, Inc., dated July 31, 1936.

The next is a letter of direction dated September 30, 1937, from Air Reduction, Inc., to Dry Ice, Delaware, 1936.

The next, a bill of sale dated September 30, 1937, from Dry Ice, Inc., Delaware, 1936, to Air Reduction, Inc.

The next, a bill of sale dated September 30, 1937, from Dry Ice, Inc., to Pure Carbonic, Inc.

And the next, a certificate of dissolution of Dry Ice, Inc., dated October 1, 1937.

Will you examine these various documents which I have enumerated and tell us if they are photostatic copies of the original papers?

A. I can so identify them.

Mr. Wilson: I will offer these two sets of papers as one exhibit.

Mr. Maddox: I object to these on the ground that they pertain to the Dry Ice Company, for a matter that is not in controversy in any of these consolidated proceedings. We are concerned with the Air Reduction Sales, Pure Carbonic, and National Carbonic. Dry Ice is wholly outside of the picture. I object to it on the ground that it is irrelevant and immaterial.

Mr. Wilson. Your Honor, the reason for offering these exhibits is because the assets of the Dry Ice Company, which made solid carbonic, went into the Pure Carbonic, Inc. It was one of the acquisitions.

The Court: Yes, it is my understanding that that was one of the acquisitions, and Pure Carbonic, Inc., is a party to this proceeding.

[fol. 67] Mr. Wilson: That is correct, your Honor.

The Court: Overrule the objection. The two sets of papers will be treated as one exhibit. They will be received as Petitioner's Exhibit 13.

(The letter of direction dated July 31, 1936; bill of sale dated July 31, 1936; bill of sale dated July 31, 1936; certificate of dissolution dated July 31, 1936; letter of direction dated September 30, 1937; bill of sale dated

September 30, 1937; bill of sale dated September 30, 1937; certificate of dissolution, dated October 1, 1937, were received in evidence as Petitioner's Exhibit 13.)

By Mr. Wilson:

Q. Now, Mr. Randall, after the dissolution of Pure Carbonic Company of America, the holding company, and the acquisition of its assets by Air Reduction Company, did Air Reduction Company purchase other companies in the carbon dioxide field?

A. Yes, I think so, two or three. I don't remember the names.

Q. Well, do you recall whether or not the Alabama Carbon Dioxide and Ice, Inc., was one?

A. Yes, that was one.

Q. In connection with those purchases, will you tell us who paid the consideration and what the consideration was?

A. Airco paid either with stock or cash or both.

Q. Yes. Now, just as illustrative, I would like to show you a set of documents, or, rather, photostatic copies of a set of documents as follows:

Bill of sale dated May 18, 1938, Alabama Carbon Dioxide Ice, Inc., to Pure Carbonic, Inc. Just one document, instead of a group. I will ask you if you can identify that photostatic copy of the orgininal?

A. This is difficult to identify. There are no signatures that I know in that, that are readable.

Q. I see.

A. It seems to me that it must be a bona fide document because it is in line with what happened, however.

Mr. Wilson: Mr. Maddox, just in the interest of expedition, will you concede this? Mr. Randall can't quite make [fol. 68] out the signatures in the photostat. They are quite faint. But if you would like to check them in any other way, we would be glad to have you do so. We will get the original for you if you would like to check it. I would like to expedite things as much as we can, but if you can't concede it, I will ask to have it marked for identification and will see that it is properly authenticated later. I assure you it is a valid document.

Mr. Maddox: That is not a very good way to prove it.

Mr. Wilson: I know, but I am trying to be expeditious. I am cognizant of what the Court said, and I would like to expedite these matters as much as possible.

Mr. Maddox: No objection.

Mr. Wilson: I will offer the paper in evidence.

The Court: It will be received in evidence as Petitioner's Exhibit 14.

(The bill of sale dated May 18, 1938, was received in evidence as Petitioner's Exhibit No. 14.)

By Mr. Wilson:

Q. Now, Mr. Randall, did the Air Reduction Company later enter the Electric welding field, by purchase of an interest in the Wilson Welder and Metals Company, Inc.?

A. Yes.

Q. Can you tell us approximately when that interest was purchased?

A. 1st of January or 2nd of January, 1931.

Q. And did Air Reduction Company later on acquire all the outstanding capital stock of Wilson Welder?

A. Yes. Some time in 1934.

Q. Yes. Then, subsequently, in or about June, 1936, did Air Reduction Company cause the capital of Wilson Welder to be reduced by some $300,000-odd to $10,000, and also the shares reduced from 10,000 to a hundred shares?

A. Yes, through a partial liquidation.

Q. Yes. And when that partial liquidation occurred, to whom were the assets transferred? The assets in excess of capital and liabilities?

A. Air Reduction Sales Company.

Q. Did you say Air Reduction Sales Company?

[fol. 69] A. No. Wilson Welder and Metals.

Q. Where were they transferred, do you recall?

A. Transferred from Wilson Welder, you mean?

Q. Yes, at the time of that partial liquidation.

A. You mean the assets that were liquidated?

Q. Yes.

A. Went back to Airco.

Q. Yes.

A. That is right.

Q. Now, I show you a set of documents in connection with that partial liquidation as follows:

Minutes of a special meeting of the Board of Directors of Wilson Welder and Metals Company, held June 30, 1936.

A certificate of change of statement respecting capital, reduction of amount of capital, and reduction of number of shares of Wilson Welder and Metals, Inc., dated June, 1936.

And a bill of sale dated July 31, 1936, from Wilson Welder and Metals Company, Inc., to Air Reduction, Inc., and a letter dated July 31, 1936, from Wilson Welder and Metals, Inc., to Air Reduction, Inc.

I will ask you if you can identify those protostats as photostatic copies of the original documents in connection with that partial liquidation to which we referred a few moments ago?

A. I so identify them.

Mr. Wilson: I offer those documents in evidence as one exhibit.

Mr. Maddox: I object on the grounds that this particular document pertains to the Wilson Welder and Metals Company. It has no relevance to the proceeding that is before your Honor in these consolidated proceedings.

The Court: What is the object, Mr. Wilson, of introducing the transactions between the Air Reduction Company and the Wilson Welder Company, neither of which are a party to this proceeding?

Mr. Wilson: Your Honor, I think they are so integrally related with the facts in issue here, and were a proper presentation of the entire method of Air Reduction Company and its branches, that we can hardly give a complete picture of the operation of Air Reduction in all its branches, [fol. 70] of which the operations of Wilson Welder and Metals were one, unless we put that in. Because we say that the electric welding machine business was simply one of the branches of operation of Air Reduction Company, and it, like the other companies, was bound to Air Reduction Company by the same kind of operating contract which we have shown as to Pure Carbonic, Sales, and National Carbide Corporation.

In other words, it is a branch, as we contend.

The Court: Yes. Well, I think I will admit it to allow you to complete your picture of the case, unless you intend to go into much greater details of the Wilson Welder and

Metals Company, which I do not presume you do, except insofar as to point out how it operated.

Mr. Wilson: I think that is correct, your Honor.

The Court: I will overrule the objection and admit the exhibit as Petitioner's Exhibit No. 15.

(Minutes dated June 30, 1936; certificate of change of statement respecting capital, reduction of amount of capital, and reduction of number of shares of Wilson Welder and Metals, Inc., dated June 30, 1936; bill of sale dated July 31, 1936; letter dated July 31, 1936; were received in evidence as Petitioner's Exhibit No. 15.)

Mr. Wilson: I might also add to my statement as to Wilson Welder and Metals Company that the Commissioner, when he threw back the revenue which we said belonged to Air Reduction Company, into the subsidiary companies, threw back that portion of it to Wilson Welder and Metals which had resulted from its operations and he also distributed or apportioned a part of the total expenses of Airco to Wilson Welder and Metals Company. That again tends to show the integrated treatment.

The Court: Well, as a matter of fact, I doubt if this particular evidence will enlarge very much the situation that has already been put in, which concerns the other three companies that did have income, and as stated awhile ago, as I have thus far observed, there is very little controversy about the facts in this case, though they will have to be developed in order for us to make findings of fact. The real controversy is as to the legal consequences of those facts. But I will admit this in order to allow you to complete your picture.

[fol. 71] By Mr. Wilson:

Q. Mr. Randall, did Air Reduction Company and Wilson Welder and Metals Company enter into an agreement, the general purport of which was that Wilson would manage and operate the plants for the manufacture and assembly or processing of electric welding and cutting machines?

A. Yes.

Q. I show you this photostatic copy of an agreement, and ask you if that is a photostat of the original agreement I have just briefly described?

A. I so identify it.

Mr. Wilson: I offer that document in evidence.

Mr. Maddox: I make the same objection. It is irrelevant to any issue in these consolidated proceedings.

The Court: The objection will be overruled and the exhibit admitted as Petitioner's Exhibit No. 16.

(Copy of agreement received as Exhibit No. 16.)

By Mr. Wilson:

Q. Now, Mr. Randall, in 1938, and prior, how much capital stock did Air Reduction Sales Company have outstanding?

A. I don't have the figures accurately in mind. I know the capitalization was small.

. . . . . .

By Mr. Wilson:

Q. Mr. Randall, I show you photostatic copies of minutes of meetings of stockholders and the Board of Directors of Air Reduction Company, Inc., for the entire year 1938, and I will ask you if you will examine those and tell us whether those are correct photostatic copies of the minutes so far as you can tell by that examination.

A. It seems to me to be a complete set.

Mr. Wilson: I offer these minutes in evidence. They have been identified as a complete set, and I understand they are a complete set of the minutes of Air Reduction Company for the entire year, all the minutes of stockholders and directors of Air Reduction Company, Inc., for 1938.

[fol. 72] Mr. Maddox and your Honor, I have a suggestion in the interests of saving time. I want to place in evidence the minutes of Air Reduction and also of each of the four companies. If it would save time and if it were agreeable with Mr. Maddox, I would be happy to have them marked only for identification at this time and perhaps he could examine them after the close of the day's session.

The Court: That would probably save time.

Mr. Maddox: I am just about through with this one. I have only a few more pages.

The Court: Well, I suggest the next ones be marked for identification so that Mr. Maddox will have an opportunity to examine them after the close of the day's session in the interests of saving time.

Mr. Wilson: Yes.

Mr. Maddox: Your Honor, I have looked at these very hastily. There are a number of pages here. I fail to see any relevancy in the exhibit to the issues that we have before us here today. They are not pertinent to these issues. They are largely made up of general authorizations of the officers salaries, and appropriations for particular work done, or items acquired. I don't see that it has any pertinency or relevancy to the issues in the proceedings.

The Court: It is rather difficult for me to see how all the minutes of a corporation like this would be relevant to the issues that we have here to decide, and I think it is a bad practice to bring in a great deal of evidence that has no relevancy to the issues that we have to try, because our court has enough to do without the examination of a lot of irrelevant evidence.

Now, in all probability some of these minutes do have direct relevancy to what the issues in the case are, but you have, as I understand it, compiled the entire minutes of the corporation for the year 1938.

Mr. Wilson: Yes. Now, your Honor, if those minutes were immaterial, I should certainly agree that all the immaterial portions should be taken out, but our theory of this cases is this: that those minutes and the minutes of the subsidiary companies go to the heart of the whole relationship that we are trying to establish here. They show that [fol. 73] all the management and direction of these four subsidiaries came from Airco. There is no better evidence of that than the minutes. They show how the appropriations were handled, they show how the bank accounts were handled, they show, as to the four subsidiary companies, that they did nothing more than formalize, in a rather routine way, the policies and directives that came from the Board of Directors, and the officers of Airco.

That goes to the heart of our theory of the case and in the interests of a complete and full presentation, we want to show that these four subsidiaries did nothing more than formalize the policies throughout the entire year 1938, which Airco and its executives and its Board laid down, and I think the best evidence of that are the minutes. I regret the voluminousness of it, but I do think that they go to the heart of the case, and to establish that these companies,

the subsidiaries, were nothing more than incorporated branches or departments or divisions of the general Airco business.

The Court: Well, the objection will be overruled and the exhibit will be admitted as Petitioner's Exhibit No. 17.

(The complete set of the minutes of Air Reduction Company for the entire year 1938 were received in evidence as Petitioner's Exhibit No. 17.)

Mr. Wilson: Now, in line with your Honor's suggestion, I would like to show the witness, at this time a photostatic copy of the minutes of stockholders and the Board of Directors of the Sales Company for 1938, the minutes of stockholders and Directors of the National Carbide Corporation, for the year 1938, and the minutes of Directors and stockholders meetings of Pure Carbonic for the year 1938, and the minutes of Wilson Welder and Metals, stockholders and directors minutes for the year 1938.

By Mr. Wilson:

Q. Will you just look at them briefly, Mr. Randall, and then I will ask leave of the Court to have them marked for identification, if you can identify them as sets of those minutes.

Mr. Wilson: And the original minutes or any papers that we have here will be submitted to Mr. Maddox for checking after court, so that we can expedite things.

[fol. 74] A. I so identify them as the complete records.

The Court: Now, if you will make a statement as to which minutes they are, we will mark them for identification.

Mr. Wilson: I will ask to have the minutes of the Sales Company marked for identification as Exhibit No. 18.

The Court: It will be so marked.

(The minutes of Sales Company were marked Exhibit No. 18 for identification.)

Mr. Wilson: The minutes of the National Carbide Corporation marked as Petitioner's Exhibit 19 for identification.

The Court: It will be so marked.

(The minutes of National Carbide Corporation were marked Petitioner's Exhibit No. 19 for identification.)

Mr. Wilson: The minutes of Pure Carbonic, Inc., marked Petitioner's Exhibit 20 for identification.

The Court: It may be so marked.

(The minutes of Pure Carbonic, Inc., were marked Petitioner's Exhibit No. 20 for identification.)

Mr. Wilson: And the minutes of Wilson Welder and Metals marked Petitioner's Exhibit 21 for identification.

The Court: Very well. It will be so marked. Mr. Maddox may have the opportunity to examine them before we reconvene tomorrow, and then you may state your objections, if any, to their admission.

Mr. Maddox: Yes, sir.

(The minutes of Wilson Welder and Metals Company marked Petitioner's Exhibit No. 21 for identification.)

By Mr. Wilson:

Q. Now, Mr. Randall, where were the general offices of Air Reduction, Inc., located?

A. 60 East 42nd Street, New York.

Q. Is that the Lincoln Building?

A. Lincoln Building.

Q. Where were the offices of the four subsidiary companies located?

A. At the general offices, the same location.

Q. And what floors do you have in that building?

A. I don't know. 18, 19, 20. I don't remember the number of them.

[fol. 75] Q. What I am getting at is: are the officers of the four subsidiary companies in the same general location in that building?

A. Yes.

Q. Yes. Now, I show you this chart which is headed "Functional Chart of Air Reduction Company, Inc., for 1938," and I will ask you if you can identify that for us, and whether you are familiar with it, and whether you can tell us whether, to the best of your knowledge and belief, that is an accurate functional and organization chart of Air Reduction Company for the year 1938.

A. I have been over it several times, and to the best of my recollection it represents accurately the chart of personnel and functions in 1938.

Mr. Wilson: I will offer that chart in evidence.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 22.

(The "Functional Chart of Air Reduction Company, Inc., for 1938," was received in evidence as Petitioner's Exhibit No. 22.)

By Mr. Wilson:

Q. Mr. Randall, a few minutes ago I asked you about the location of the general offices of Air Reduction Company and the four subsidiary companies. Did your answer to my question apply to the year 1938 as well as to other years?

A. Yes, sir.

Mr. Maddox: May I ask what you mean by "as well as other years"?

Mr. Wilson: Well, I want to show that it didn't originate in December of 1938, for example. It had been going on all the time, Mr. Maddox, throughout the taxable year, and long prior and long since.

By Mr. Wilson:

Q. Now, Mr. Randall, I show you this schedule, which purports to be a schedule of Air Reduction Company, Inc., showing the officers of Air Reduction Company, Inc., and the agency companies during the year 1938, and I ask you if you are familiar with this schedule and whether, to the best of your knowledge and belief, that is an accurate representation of the officers and companies during the year 1938.

[fol. 76] A. That seems to be an accurate schedule.

Mr. Wilson: I offer the schedule in evidence.

Mr. Maddox: No objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 23.

(Schedule of Air Reduction Company, Inc., was received in evidence as Petitioner's Exhibit No. 23.)

By Mr. Wilson:

Q. Now, with reference to the officers who are listed in Petitioner's Exhibit No. 23, Mr. Randall, did each of those officers, so far as you know, have offices at 60 East 42nd

Street, in the general offices of Air Reduction Company, Inc.?

A. Yes, with one or two minor exceptions.

Q. What is that minor exception? Assistant Secretary?

A. Well, there was an assistant secretary, and I think a vice president of one of the subsidiary companies on the Coast.

Q. But, with that minor exception, the statement is true, isn't it?

A. Yes, sir.

Q. Now, Mr. Randall, I ask you to look at that organization and functional chart, which has been marked Petitioner's Exhibit 22. Just so that we understand it a little more clearly, the various branches of the Air Reduction Company, Inc., business, break-down according to that chart, do they not, into the corporate branch, the operations branch, the sales branch, the financial branch, the distribution branch, and the research branch: is that right?

A. That is correct.

Q. As appears from that chart, were each of those branches supervised and directed by a vice president of the Air Reduction Company, Inc., with the exception of the distribution branch, which was directed and supervised by Mr. Hawkins, who was an assistant vice president?

A. That is correct.

Q. And that was true throughout the year 1938?

A. Yes, sir.

Q. And at other times fore and aft; is that right?

A. That is right.

[fol. 77] Q. Now, throughout the year 1938, you were vice president in charge of that first branch, were you not, the corporate branch?

A. Yes, sir.

Q. How many did you have under your supervision throughout that year, and at other times?

A. Well, I had Mr. Spence.

Q. You may refer to the chart.

A. In the Bureau of Business Relations. Mr. Davidson and his immediate subordinate—Mr. Davidson being secretary—and Mr. Ogier, who was the executive vice president of Pure Carbonic, Inc.

Q. In 1938, you were a vice president of Air Reduction Company, of Air Reduction Sales Company, of Pure Carbonic, Inc., and Wilson Welder and Metals; is that right?

A. That is correct.

Q. And did you have supervision and charge over the entire secretarial department?

A. I did.

Q. Or Secretary's department?

A. Yes, sir.

Q. And who was the secretary of Air Reduction Company during the year 1938?

A. Robert B. Davidson.

Q. And was he secretary of other companies as well?

A. All of the companies, yes.

Q. He was secretary of Air Reduction Company and each of the four subsidiaries; is that right?

A. That is correct; yes, sir.

Q. Now, there were the various assistant secretaries throughout the year 1938 who reported to Mr. Davidson, the secretary, and through him to you as supervising vice president?

A. That is correct.

Q. Will you just tell us for the record who they were?

A. T. G. Harrison; E. R. Humann, and A. J. Thoma.

Q. Were those three men whom you named assistant secretaries for Air Reduction Company?

A. And for all the companies.

[fol. 78] Q. They were assistant secretaries for Air Reduction and for each of the other four companies?

A. Yes, sir.

Q. Throughout the entire year 1938?

A. Yes, sir.

Q. For what company or companies did the secretary's department perform services throughout the year 1938 and other years?

A. For what?

Q. For what company or companies?

A. Well, for Air Reduction Company, Inc., and for all the subsidiary companies.

Q. It functioned and served on behalf of the whole organization?

A. The whole organization; yes, sir.

Q. Were any of the employees of the Secretary's Department identified with any particular company?

A. No, sir.

Q. Now, I notice there that, on the chart, there appears the name of Mr. T. G. Harrison, assistant secretary of all

companies. Will you tell us just very briefly what phase of the work Mr. Harrison had charge of in 1938?

A. Well, Mr. Harrison has been with the company a long time, and he had charge of contracts, filing, analysis of contracts, when in the process of filing, distribution of the analyses. He made contacts with general counsel, and made himself useful generally as a sort of amateur house attorney.

Q. And did he function on behalf of Air Reduction Company and for each and all of the other subsidiaries?

A. Yes, sir, all of them.

Q. How was the matter of expenditures by the subsidiary companies handled, Mr. Randall?

A. On an appropriation basis. Any expenditure over $500 had to be requested by the head of the department requiring the expenditure, and it went before the Airco Board and was approved or disapproved at their pleasure.

Q. Did it first go to the Chairman of Air Reduction Company?

A. Yes, his signature was on it first.

[fol. 79] Q. For approval of the Chairman?

A. Yes.

Q. And then if he approved, it had to be further approved by the Board of Directors of Air Reduction Company?

A. That is correct.

Q. And was that true of all expenditures that had to be made by any of these four subsidiary companies?

A. Anything above $500.

Q. And that was true throughout the year 1938, was it?

A. Yes, sir.

Q. In connection with this matter of expenditures, I show you photostats of various documents. I will ask you if they are photostats of originals, and whether they are illustrative of the procedure regarding the approval of expenditures by the subsidiary companies.

The first of these is entitled "Appropriation Request for Air Reduction Sales," bearing date of October 19, 1938.

The next is entitled "Appropriation Request for National Carbide Corporation," dated September 7, 1938.

The next is entitled "Appreciation Request for Pure Carbonic, Inc., October 21, 1938."

And the next is entitled "Appropriation Request for Wilson Welder and Metals," dated September 23, 1938.

And the last is entitled "New Requests for Appropriations Submitted to the Board of Directors of Air Reduction Company, Inc., October 26, 1938."

I will ask you if you can identify those photostats as photostats of original documents, and as being typical of the procedure which was used with reference to appropriations throughout the entire year and at other times.

A. It represents standard procedure, absolutely.

Q. Throughout the year 1938 and at other times?

A. Yes, sir.

Q. That was your standard procedure?

A. Yes, sir.

Mr. Wilson: I will offer all those documents in evidence as one exhibit.

Mr. Maddox: No objection.

[fol. 80] The Court: It will be received in evidence as Petitioner's Exhibit 24.

(Documents entitled "Appropriation Request for Air Reduction Sales," October 19, 1938; "Appropriation Request for National Carbide Corporation, September 7, 1938;" "Appropriation Request for Pure Carbonic, Inc., October 21, 1938;" "Appropriation Request for Wilson Welder and Metals, September 23, 1938;" "New Requests for Appropriations Submitted to the Board of Directors of Air Reduction Company, Inc., October 26, 1938," were received in evidence as Exhibit No. 24.)

The Court: It will be received in evidence.

* * * * * * * *

By Mr. Wilson:

Q. Mr. Randall, the last document in Petitioner's Exhibit 24 was this paper which is headed "New Requests for Appropriations." Do you recall that?

A. Yes, sir.

Q. Now, I direct your attention to Petitioner's Exhibit 17, which are the minutes of stockholders and directors of Air Reduction Company, Inc., for 1938, and particularly to the minutes of the directors under date of October 26, 1938, and more particularly still to pages 220 and 221 of those minutes, and I ask you if that portion of those minutes deals with that request for new appropriations to which I have just directed your attention?

A. Mr. Wilson, I confess I don't quite understand what you want me to do. Do you want me to verify these totals?

Q. No. I just want to connect up the situation in this way, by asking you whether or not the new requests for appropriations which appear in Petitioner's Exhibit 24 are dealt with in these minutes of the Board of Directors of Airco to which I called your attention?

A. Yes, definitely.

Q. Now, if you will look at your chart, Mr. Randall, I notice that Mr. E. R. Humann was assistant secretary of all companies, including Airco and the four subsidiaries. Will [fol. 81] you tell us just briefly what services he performed for each of those companies?

A. Well, he was the Federal tax man, to begin with, for all the companies. He made the returns and handled any detail or any question that came up in the way of detail. And he made the general audits for all the companies.

Q. Now, with respect to Mr. A. J. Thoma, what particular services did he perform in his particular section, for Airco and the four companies?

A. He was the insurance expert for all types, and in conjunction with Mr. Davidson and with my approval, they placed insurance, collected in the case of losses, and so forth.

Mr. Thoma handled, and very competently, I always thought, both state and local taxes, making the necessary returns, and negotiating a fair settlement on taxes, if there was any question brought up by the local assessor.

Q. Now, the Mr. Davidson you referred to was the secretary for all companies?

A. Yes, sir.

Q. So far as insurance was concerned, will you tell us how applications for insurance were made?

A. I think almost universally the insurance was taken out in the name of Air Reduction Company, Inc., and billed to Air Reduction Company, Inc., and when occasion for collection on a loss occurred, Air Reduction Company got the money. That has almost universally been the way it was handled. There might have been an exception.

Q. In other words, were the applications for insurance made by Air Reduction for each of the subsidiary companies?

A. For each and every company, yes.

Q. And what was the general practice as to the issuance of the insurance? What names?

A. Well, any name, of any one or all of the subsidiary companies, might be named in the policies as beneficiaries.

Q. And can you tell us how the premium on such insurance was billed, or to whom?

A. To Airco, I am sure.

Q. The parent company?

[fol. 82] A. Yes, sir.

Q. And was that the situation that existed throughout the year 1938, and at other times?

A. Yes, sir.

Q. Did the insurance section also have charge of accident prevention and control for Air Reduction Company and each of the four subsidiaries?

A. Yes, they had a uniform Safety First Section.

Q. And did they make reports to the secretary?

A. Well, first the field man made a report to them, and they analyzed it, and then they reported to the secretary, and the secretary, in turn, reported to the involved department in New York.

Q. Now, I notice from the chart, the organization and functional chart, Exhibit 22, that Mr. W. W. Ogier, vice president, reported in connection with the sales of Pure Carbonic Company; is that right?

A. Well, substantially right, because I think we had taken most everything out of Pure and given to Airco to handle, except sales. But any question that arose in the administration of Pure Carbonic was referred by Mr. Ogier to me if he thought it was necessary to do so.

Q. Now, who had charge, during the year 1938, of the sales of carbon dioxide and gaseous liquid in solid form?

A. G. C. Cusack.

Q. What was his position?

A. He was a vice-president of the portfolio, vice president in charge of sales, in other words.

Q. Of what company?

A. Pure Carbonic, Inc.

Q. Did he report to Mr. Ogier?

A. He did.

Q. And then Mr. Ogier reported to you; is that right?

A. That is correct.

Q. How many district sales offices, approximately, did Pure Carbonic Company, Inc., have in the year 1938?

A. 18.

Q. And was there a district manager in charge of each of those district offices?

[fol. 83] A. Well, I don't remember exactly. There was a district manager normally in charge of an office, big enough to handle the expense of a district manager. There were some other offices where we utilized the Air Reduction Sales Company district manager as a Pure Carbonic District Manager.

Q. That is, where the sales activities of Pure Carbonic and of the Sales Company dealt within, one might say, consolidated form, under one district manager in certain offices?

A. That is right.

Q. Is that a correct statement?

A. That is correct.

Q. Can you name for us a few of the district offices where that kind of joint activity took place?

A. Well, it occurs to me that it occurred in Seattle, Washington, and Portland, Oregon, and New Orleans.

Q. How about Milwaukee?

A. I don't remember much about it, to tell the truth.

Q. It wasn't made famous enough in that respect?

A. No, sir.

Q. How about the employees in these offices where this joint type of activity was carried on? Did these employees serve any one of those two companies, or did they serve both? What was the situation?

A. They served both.

Q. Now, in certain of these district offices, did the Sales Company and Pure Carbonic occupy the same offices for both companies?

A. Yes.

Q. And were the employees in each of those district offices which you have mentioned under the same general administrative control?

A. Yes, sir.

Q. How about the credit managers in those offices where the joint activities were performed?

A. He worked for all companies, and reported, of course, to New York.

Q. Mr. Randall, I refer you again to these contracts between the parent and the subsidiaries, these so-called oper-

[fol. 84] ating contracts which have been placed in evidence

as Petitioner's Exhibits 2, 6, 8, 9, and 16; you recall the contracts that I refer to?

A. Yes, sir.

Q. Were those contracts, all of them, in full force and effect in 1938?

A. Throughout the year, yes, sir.

Q. Just as we put them in evidence here and without amendment or change?

A. Yes, sir, that is correct.

Q. And were these the only contracts of that general type in effect throughout the year 1938 between Air Reduction Company and the four subsidiary companies?

A. Yes, sir.

Mr. Wilson: Your witness, Mr. Maddox.

Cross-examination.

By Mr. Maddox:

Q. Mr. Randall, have you always been Vice President of Air Reduction and the subsidiaries, since their inception?

A. I was Secretary of the Company, of the main Company, from 1916, about the middle of the year, to 1924. I was elected Vice President of the main Company, Airco, as we call it, in 1922, and held that office through to my retirement at the end of 1944. I am not exactly clear that I had the office of Vice President of the subsidiary companies for the entire term that I was Vice President of Air Reduction Company. The record, of course, would show.

Q. I refer you to Petitioner's Exhibit 3, and ask you if that is your signature.

A. That is my signature.

Q. And does that indicate that you were secretary of that subsidiary at that time?

A. Yes, sir.

Mr. Maddox: Do you have the original of Petitioner's Exhibit 2, Mr. Wilson?

Mr. Wilson: Not here.

By Mr. Maddox:

Q. Do you recall your testimony that this was typical of the others? Does this refresh your recollection of the office you held in the subsidiary companies in 1917?

[fol. 85] A. If I understand your question correctly——

Q. I am asking if that refreshes your recollection as to what office you held in the subsidiaries in 1917.

A. Well, I don't think it is any different from what I said a few minutes ago, that I was secretary of the Company, Air Reduction Company, from 1916 to 1922.

Q. And what about the subsidiaries? I am asking you what position you held in the subsidiaries.

A. I don't recall, but if I signed for a subsidiary there, I certainly was qualified as Secretary.

Q. Well, does that refresh your recollection as to holding office in the subsidiary in 1917?

A. Did I sign for Air Reduction Sales Company?

Q. You signed this contract for Air Reduction Company of New Jersey, and you testified that this was typical of the other contracts entered into on the same date.

A. Well, then, I was Secretary of the Air Reduction Company of New Jersey.

Q. Did you know Mr. Walter W. Birge?

A. Very well.

Q. And he was President of the companies at that time? The Air Reduction company and the subsidiaries?

A. Presumably all subsidiaries. He was the boss.

Q. Were there any minutes that authorized the execution of these contracts, such as Petitioner's Exhibits 2 and 3?

A. Well——

Mr. Wilson: May the record show, and may we have the benefit of knowing, what Petitioner's Exhibits 2 and 3 are?

Mr. Maddox: Petitioner's Exhibit 2 is the agreement of March 1st, 1917, between Air Reduction Sales Company and Air Reduction Company.

Mr. Wilson: Thank you.

The Witness: Answering your question, I couldn't recall now whether there were minutes or not.

By Mr. Maddox:

Q. Do you recall whether there were any minutes authorizing the contract, Petitioner's Exhibit 3.

A. No, I can't recall that either.

[fol. 86] Q. Have you looked that matter up recently?

A. No sir.

Q. Do you recall that there was any discussion of these contracts before they were entered into?

A. Well, I know there was among ourselves. I don't know whether——

Q. Can you recall what the discussion was? The substance of it?

A. Yes, I think I can.

Q. What was it?

A. I take it that you are driving at the idea that there was discussion as to whether this was a good policy? Do you mean discussion of policy?

Q. I am talking about the discussion that wound up in the execution of the contract, Petitioner's Exhibit 2, for instance, the one between Air Reduction Company and Air Reduction Sales Company.

A. Yes, that would be a policy matter, a discussion of policy, wouldn't it, that you refer to?

Q. Is that all you recall about the discussion?

A. Well, no; I will tell you what I recall about the discussion, if that is what I am to talk about. We had acquired five Superior companies, or some portion of the five companies, and they were run on an independent or loose basis, and they were giving themselves a lot of trouble before we took them over, and we thought that we ought to get some kind of vehicle for centralising our control in New York, and handling these widely separated companies in the field. Hence, the agreement of March 1st, 1917.

Q. Well now, you speak of the Superior companies. Were they originally Airco companies?

A. No, sir, they were independent companies which were acquired.

Q. And were they a related group?

A. They were related, but not controlled.

Q. Now there were the other subsidiaries, that bear names such as "Air Reduction Company of Michigan", and "Air Reduction Company of New Jersey".

A. Those were organized by Airco.

[fol. 87] Q. They were established by Airco, were they not?

A. Yes, sir.

Q. Whereas the Superior companies were operating companies that you purchased?

A. That is correct.

Q. Did you acquire the companies' stock, or did you

acquire the assets of the companies? The Superior companies?

A. We acquired the assets, as I recall it.

Q. And did you organise new companies under the name of Superior companies?

A. No, sir.

Q. Were they separate and distinct companies?

A. Yes.

Q. Organized by you, that is by Airco?

A. No, sir.

Q. Then did I correctly understand your testimony? I understood you to say you acquired the assets of the Superior companies.

A. Yes, we took over the business and assets of the companies.

Q. Did you acquire the stock or did you acquire the assets?

A. I really don't remember now whether we got stock in all of them or only some of them, or in none of them.

Q. Well, you either got stock or you got assets and organized new companies, isn't that true?

A. Well we didn't have to organize the Superior Oxygen companies.

Q. They were already in existence?

A. No; I say, if we took the assets and wanted to organize a company to handle them, we didn't have to organize a Superior Oxygen company. Or, in other words, we would use Air Reduction Sales Company.

Q. They were operating companies, were they not, at the time you acquired them?

A. Active, do you mean?

Q. Yes.

A. Oh, yes; sure.

Q. Did you make any change in their operation?

A. Yes; quite a good deal of change.

[fol. 88] Q. Immediately?

A. Progressively.

Q. How progressively?

A. Well, as we took them over, we found that their accounting was all—each company had an independent system of accounting, and we centralized the accounting in New York, and then intended to decentralize it later on, but in the meantime the companies were dissolved, and we didn't

have to decentralize it. They had another way of doing it. We also—I have lost your question.

Mr. Maddox: Will you read the question please, Mr. Reporter?

(Question read.)

The Witness: On operating technique, there was a process known as the Hillebrandt Process, of getting Oxygen from air, which was taken out gradually, and for which the Airco Oxygen system was installed. Just what period of time that took, I don't know. Mr. Van Vleet would know that better than I would.

By Mr. Maddox:

Q. When did you acquire the Superior companies?

A. Well, I don't know whether I know off-hand or not. Let me see if I do. Progressively from 1916 to 1920, my memorandum here says.

Q. And they were continued until what time? Do I recall correctly that in your direct examination you said until about 1934, and then the last one in 1936?

A. Well, I see some of them were dissolved in 1935, 1936, 1934, 1935.

Q. So by progressively, do you mean between those dates of acquisition and those dates of dissolution?

A. Roughly, yes.

Q. And were those Superior companies operated under a contract comparable to Petitioner's Exhibit 2?

A. Yes.

Q. That is the one between Airco and Air Reduction Sales?

A. Yes; if they were still going at the time when the contracts were given to the acquired and organized companies, they got a contract.

[fol. 89] Q. However, those companies were substantially capitalized? I mean, they had substantial capital stock outstanding, did they not?

A. I don't recall, but I presume so; yes, sir.

Q. That is also true of the Air Reduction Companies of Michigan, New Jersey, Ohio, and other companies of that type?

A. Well, they didn't have anything except what Airco gave them.

Q. Well just how did you proceed in the organization of those subsidiary companies, the companies bearing the names: "Air Reduction Company of Michigan", for instance, and companies of that kind?

A. We applied for a franchise, paid the bills——

Q. Did you pay anything for stock?

A. Yes; whatever stock was issued.

Q. And took the money and constructed a plant?

A. If there was enough money; if there wasn't enough money we gave them money.

Q. Gave them additional money?

A. That is right.

Q. So that they had an operating plant?

A. That is right.

Q. And they were substantially capitalized?

A. I don't remember the capitalization of them.

Q. Well, do you remember whether it was substantial or nominal?

A. I think not. I think it was nominal. That is my opinion.

Q. I show you certain papers and ask you if you can identify those?

A. Yes. These are all identifiable from the signatures.

Q. And these are information returns of the subsidiaries of Air Reduction?

A. Yes, sir; these are.

Q. Now I direct your attention to those: Minnesota Air Reduction Company; Air Reduction Company of California; Air Reduction Company of New Jersey; Air Reduction Company of Michigan; Ohio Air Reduction Company, and Air Reduction Company of Virginia; and I direct your attention [fol. 90] to the answer to question 4, or at least to the information required by item 4, and ask you if those companies were nominally or substantially capitalized?

A. Well, of course, my answer, or my guess, was wrong; they are substantially capitalized, apparently. All in common stock, with one exception, which is this Air Reduction Company of Virginia.

Q. And directing your attention to item 1, the date of incorporation of that was what?

A. December 21, 1918.

Q. And does that account for the small amount there?

A. I wouldn't know. I don't know exactly why it was incorporated.

Q. Now these companies all had a plant that was owned by them, isn't that correct?

A. They had legal title to the plants.

Q. Who owned the stock of these companies? Wasn't Air Reduction Company the owner of that stock?

A. Yes, sir; I presume so.

Q. I now refer you to Petitioner's Exhibit 3, and particularly to Article III, sub-division 8, which provides, in effect, that during the continuance of the contract, Sales Company will pay to Air Reduction Company of New Jersey, 12.5% per annum on the largest amount of capital shown on the books of the Jersey Company, and I ask you how you arrived at that 12.5% figure as expressed in that contract?

A. I haven't the slightest idea.

Q. You don't have any recollection of it?

A. I don't have any recollection of it, no, sir.

Q. Do you recall how you arrived at the comparable item in Petitioner's Exhibit 2? Of 6% on that Sales nominal capital stock?

A. I think 6% was an interest rate, that is derived from an interest rate, but I can't imagine what the 12.5% was.

Q. Now, going further into Petitioner's Exhibit 2, the first article says that: "Airco hereby employs Sales as its agent to manage and operate." Did the Sales Company have an organization to carry out that provision?

[fol. 91] A. Yes, sir.

Q. In your direct examination you also stated that when Airco acquired a plant—and I think the contracts bear it out—those plants were transferred to Air Reduction Sales Company, isn't that correct?

A. That is correct.

Q. And what did Airco take back for the plant transferred?

A. The legal title, in the local company——

Q. I am asking you what did Airco get for the plant that they turned over to Sales Company?

A. They got whatever the plant cost.

Q. Did they get stock?

A. No, they didn't get stock. They got an account receivable on their ledgers, versus an account payable on the Air Reduction Sales Company ledger.

Q. And in what amount would that be?

A. How would I know? It would depend on the size of the plant.

Q. Well but how did you determine the amount to credit to the account payable on the subsidiary's books, and to charge to accounts receivable on the parent company's books?

A. Well assume, for the matter of argument, that we had purchased the company; that would put some value on it, wouldn't it?

Q. Well it wasn't an arbitrary amount, was it? You didn't arbitrarily——

A. It wasn't just picked out of thin air, no.

Q. You put down the amount that it had cost?

A. Probably.

Q. Or did you, if you acquired the plant by the issuance of stock, value the stock, and did you use the resulting figure for that charge to the account receivable on the parent's books and the credit to the account payable on the subsidiary's books?

A. I believe so.

Q. Has that practice been consistently followed?

A. I don't know.

Q. Throughout all the years?

A. I don't know, sir.

[fol. 92] Q. Do you recall any exceptions?

A. No.

Q. Did a subsidiary ever purchase a plant itself?

A. Out of its own money, you mean?

Q. Yes.

A. No, sir, not to my knowledge.

Q. The account receivable on the parent company's books, and the corresponding account payable on the Air Reduction Sales Company's books, for example, was comparable to the entire investment that appears on the balance sheet of Air Reduction Sales Company, isn't that correct?

A. That is correct.

Q. Did the Sales Company ever pay that account? Was it ever in a position to pay that account?

A. Not in full, but it paid in, of course, because as earnings came in, there was some credit to that account.

Q. As what came in?

A. Earnings. I presume there were some earnings.

Q. In addition to the cost of plant or plants, then, the account receivable on the parent company's books and the corresponding account payable on the subsidiary company's books also contained the earnings from the plant, is that correct?

A. I don't know. I have an idea that it did not contain the earnings.

Q. What happened?

A. The earnings were consolidated with Airco's earnings, weren't they?

Q. Well, just what was the record on the two companies' books, generally?

A. I didn't understand you.

Q. What was the record on the two companies' books, with reference to earnings?

A. Well, I am not qualified to answer this line of questioning.

Q. Was ever any interest charged on the account?

A. I don't know anything about the accounting on it.

Q. Were you not in charge of those things, according to the chart?

A. No.

Q. Who was in charge of the records?

[fol. 93] A. Look at your financial section, there, to the right.

Q. You mean Mr. Keeley?

A. Mr. Keeley, yes.

Q. But you were familiar with the the general corporate set-up, were you not?

A. Yes, I was, but this was 25 or 30 years ago, you know.

Q. I am talking about 1938.

A. Well, that is a long time ago, too.

Q. Do you recall of any interest ever being charged between the Air Reduction Company and the Air Reduction Sales Company on that account?

A. I wouldn't know. It wouldn't have come to my attention, and I don't know.

Q. You have no knowledge of that?

A. Therefore I can't recall it, no.

Q. Was that account ever reduced by any payments between Air Reduction Sales and Air Reduction?

A. I don't know, sir.

Q. You don't know?

A. No, I don't know whether it was ever reduced.

Q. Did the Air Reduction Company manufacture the cylinders that you spoke of?

A. Air Reduction Company, Inc.?

Q. That is right. Did they manufacture the cylinders?

A. No, sir.

Q. But you say they were owned at all times by Air Reduction Company?

A. Yes, but they were purchased outside, from other sources.

Q. They were manufactured by a steel company and purchased by Air Reduction?

A. Yes, sir.

Q. What was the reason for Air Reduction Company retaining the ownership of the cylinders?

A. I don't know. I don't recall.

Q. Didn't it consistently retain the ownership of the cylinders between the years 1917 and 1938, and throughout 1938?

A. I believe it did, yes, sir.

Q. And that was true of Pure Carbonic of America when it was in existence, wasn't it?

[fol. 94] A. I think so, yes.

Q. As a general proposition, isn't this true, that the cylinders in which the gas was stored, and the trucks in which it was distributed, were owned by the Air Reduction Co.? Isn't that correct?

A. The cylinders were owned by the Air Reduction Company.

Q. But not the trucks?

A. Not the trucks, I believe. I am not sure of that, even.

Q. Where were the trucks? Didn't you have considerable in the way of trucks, for distribution?

A. Yes.

Q. Where were they?

A. You mean, in what physical location?

Q. In what company.

A. I don't know.

Q. But they were not in Air Reduction Company?

A. I don't know.

Q. Was the oxygen gas and the carbonic acid gas distributed in the same trucks?

A. Very often, yes, sir.

Q. Did they serve generally the same customers?

A. No, sir, very different.

Q. Very different trade, isn't it?

A. Different trade entirely, but they might be located so that it would be convenient to serve them so.

Q. To what extent would it be true, then, that the same trucks were used for both oxygen and carbonic acid gas?

A. I don't know.

Q. Didn't you in your direct examination, stress that point?

A. I said that Airco was interested in the acquisition of a carbon dioxide business because it involved the trucking of cylinders and Airco had a large fleet of trucks, but I don't know, and couldn't make even the wildest guess, as to what proportion of the loads on those trucks were carbon dioxide loads and what proportion was oxygen.

Q. Do you recall the minutes for 1938, Petitioner's Exhibit 17?

A. The full year's exhibit?

[fol. 95] Q. The minutes of the Board of Directors meeting for Airco.

A. Yes, I recall that.

Q. And Petitioner's Exhibit 24, the procedure for appropriations?

A. Yes, sir.

Q. And do you recall there that specific items were covered by specific companies?

A. Yes. But all acted on by the Airco Board.

Q. In other words, they bought trucks in some instances for one company and in other instances for another company, did they not?

A. It could be.

Q. Do you want to look at these exhibits again?

A. Well, I don't know that it would profit me any. I know that they could have bought certain equipment for one company or another company.

Q. These Petitioner's Exhibits 17 and 24 do not disclose indiscriminate buying for all the companies, do they? Don't they disclose buying for each individual company? Buying of equipment, that is, for each individual company?

A. Well, why shouldn't they buy for each individual company, if they agreed to do it?

Q. Well there wasn't any question of buying a truck to be used by all companies, isn't that true?

A. I didn't understand that.

Q. There wasn't such a thing as buying one truck for all

of the companies, so that it would be indiscriminately used by all companies?

A. Oh, yes, there was. That could be used by Air Reduction deliveries for the delivery of products of any one of the companies.

Q. Didn't those trucks——

A. (Interposing:) Or all of them.

Q. Didn't those trucks bear the name of the company on them?

A. Some of them did, and some of them did not.

Q. Am I mistaken when I see a truck labelled "Air Reduction Sales Company?"

[fol. 96] A. No, you are not mistaken, because right now Air Reduction means the whole group.

Q. No, I said Air Reduction Sales Company.

A. Oh, Air Reduction Sales Company. That still means the whole group, as far as deliveries are concerned, in many instances.

Q. Am I also mistaken if I see a truck with the name of Pure Carbonic, Inc., on it?

A. No, you can see such a thing.

* * * * * * *

By Mr. Maddox:

Q. Mr. Randall, I have before me the organizational chart, Petitioner's Exhibit 22. Do you recall that?

A. Yes; I have a copy of it.

Q. I am not quite clear just what the functions of your position were. Could you set forth the scope of your position as it is represented on this chart more fully?

A. Well, I had direction of what is called, on this chart, the corporate section.

Q. Yes.

A. Which is the first on the left. I was vice president of the companies mentioned in the first box. Mr. Davidson, the secretary, reported to me.

Q. I don't want to interrupt, but what I am interested in are your functions and duties more than your position. I understand your position with the different companies. I want to understand your duties.

A. General supervision.

Q. Of what?

A. Of that section of the business.

Q. Well, what would that be? What would you supervise?

A. Mr. Davidson's activities as secretary.

Q. Well, what would the scope of that be?

A. Secretarial work entirely.

Q. Records?

A. Some records, yes.

Q. Would that exclude the financial books?

A. Yes, sir.

[fol. 97] Q. Now, has your position always been as it is designated on this chart?

A. Well, no. In the early days I had a job without a title, then I got a title as secretary and then I got the title of vice president.

Q. Well, what I am trying to understand is the scope of your knowledge of the functions of these corporations over the period of years that you have been with the company. I understand you were with the company from its inception to 1944.

A. Yes, sir. I had a pretty good knowledge of the functions of the companies and their subsidiaries, but not a technical knowledge, such as production and as would be involved in production, or financing or accounting or any of those things.

Q. Did you have anything to do with the sales? Selling?

A. Only insofar as a case of a subsidiary company, like Carbonic reporting to me. In that case I did have some contact with the sales end.

Q. Well, did your work deal principally with policy matters?

A. Well, with the application of policies, I would say. The policies were set by the chief executives. I applied those policies to the best of my ability.

Q. And I assume that you had nothing to do with the research angle of it?

A. Nothing at all, no.

Q. Now, the various companies, we were speaking about yesterday, I believe. The superior companies, for instance. They continued as companies owning assets until their dissolution; isn't that correct?

A. I believe that is correct. I am not sure.

Q. And that is also true of the Air Reduction Company of Michigan and similar companies of that type?

A. Yes, sir.

Q. Now, the Air Reduction Company of Michigan, New Jersey, Ohio, Minnesota, California, Virginia, and Massachusetts. Do you recall those?

A. Yes, sir.

Q. They were dissolved in 1936, as I recall?

A. I think that is right.

[fol. 98] Q. Or thereabouts?

A. Some of them maybe after that. I am not sure.

Q. The assets of those companies and the assets of the superior companies were distributed to Air Reduction Company in liquidation; is that what you mean?

A. Either directly to Air Reduction Company—but I think more often the assets were directed by Air Reduction Company to Air Reduction Sales Company.

Q. That was by direction of——

A. Air Reduction Company.

Q. Air Reduction Company to Air Reduction Sales Company?

A. To the subsidiary company, that is.

Q. Well, that is true of the companies I have enumerated and also the superior companies. They went in distribution and liquidation to Air Reduction and then by Air Reduction to Air Reduction Sales.

A. That is right. And that was, of course, to enable Air Reduction Sales Company to carry out its agency agreement.

Q. Well, is it not a fact that the agreement—I assume you are referring to Petitioner's Exhibits 2 and 3, 3 being typical of a number. Do you have those in mind?

A. Yes, sir. I think Petitioner's Exhibit 2 is the agreement betwen Airco and Air Reduction Sales Company.

Q. Yes. Petitioner's Exhibit 3 is the typical agreement between Sales and one of the other subsidiaries?

A. That is right.

Q. In this instance it is precisely Air Reduction Company of New Jersey.

A. Yes, sir.

Q. And there was a similar contract between Sales Company and each one of the Air Reduction Companies of Michigan, New Jersey, Ohio, Minnesota, California, Virginia, and Massachusetts?

A. I believe that is true.

Q. And also an agreement between Sales Company and each of the superior companies; isn't that true?

A. I am not clear about that, Mr. Maddox.

[fol. 99] Q. I show you a paper and ask you if you can identify that paper.

A. Yes, I can identify it as a tax return for 1936.

Q. Of what company?

A. Air Reduction Company, Inc.

Q. Now, I refer you to a number of schedules which are attached to it——

Mr. Wilson: Mr. Maddox, I am afraid I can't hear you very well. It is a little bit too much of a tête-á-tête.

Mr. Maddox: I am sorry. I didn't mean it that way.

By Mr. Maddox:

Q. I refer you to a number of typewritten schedules attached to the printed form, and directing your attention to —I beg your pardon, I have the wrong return. I direct your attention to another paper, and ask you if you can identify that.

A. This one?

Q. Yes.

A. Yes, I think so.

Q. And what is the paper?

A. It is a tax return for Air Reduction Company, Inc., for the calendar year 1934.

Q. Now, I direct your attention to the typewritten schedules attached to the printed form, and particularly the schedule designated as "Z" and you will note there 14 listed agreements. I also refer you to those exhibits which are marked Z-1 through Z-14, and ask you to examine those and see if that refreshes your recollection as to the information I asked for in my question that you said you didn't recall.

A. Well, I have lost my place—I have got it now. Thank you. Yes, it does. It is obvious that Superior Oxygen Companies, five of them, did have these agency agreements with Air Reduction Company.

Mr. Wilson: Mr. Maddox, have you any objection to putting those agreements in evidence? They speak better than anything else as to their content.

Mr. Maddox: I thought we had already covered it in your direct examination, when the witness said that similar agreements were entered into by other companies.

[fol. 100] Mr. Wilson: I am merely suggesting, in the interests of a complete record, as to these various companies.

Mr. Maddox: I have no objection. It seems cumulative.

The Court: Would there be any advantage to it, inasmuch as the testimony yesterday was to the effect that certain papers were typical of those that were entered into between the other companies? These are not different, are they?

Mr. Maddox: So far as I know, they are not, and I understood from Mr. Wilson's statement that this is typical of them. I was simply trying to get before the Court just what companies they were.

Mr. Wilson: Yes, I think that is all right.

The Court: Well, then, probably you are prolonging unnecessarily some of it, but I don't wish to criticize you for that.

By Mr. Maddox:

Q. Now, the agency contracts were in existence prior to 1936, or such other dates as these various subsidiaries were dissolved; isn't that correct?

A. Yes, indeed.

Q. Now, what was the difference between the setup prior to dissolution of those subsidiaries and after dissolution?

A. Well, when those subsidiaries were in existence, either acquired subsidiaries or organized subsidiaries, they did the business, they used the assets that had been turned over to them to conduct the business locally. After their dissolution, Air Reduction Sales Company took their place and ran the businesses under direction of Air Reduction Company, Inc.

Q. Well, prior to the dissolution of those companies, did Air Reduction Company do any directing or supervising?

A. It certainly did, yes, sir.

Q. What is the difference in that before and after dissolution?

A. As far as the direction was concerned?

Q. Yes; the function of Air Reduction Company.

A. It was much more difficult to run those many separate companies and make policy effective on a multitude of points when we had 14 or 15 subsidiary companies than it was after Air Reduction Sales Company took over the business, when

[fol. 101] we pressed the policy upon the management of Air Reduction Sales Company who had worked in the field all the time and could make the policy effective at all points.

Q. Well, was the supervision and direction of Air Reduction Company any different?

A. No. Of Air Reduction Company, no, it was the same.

Q. Of the subsidiaries, it had after that time?

A. Different because——

Q. Of dissolution of the various subsidiaries?

A. It was more effective for the reason that I have just stated.

Q. Now, are you acquainted with the Magnolia Airco Gas Products Company?

A. Yes.

Q. Crystal Pure Carbonic, Inc., of Texas?

A. Yes, sir.

Q. And the Commercial Acetylene Supply Company, Inc.?

A. Yes, sir.

Q. Can you tell me what happened to those companies in 1936?

A. Those companies were never included in the agency agreements. Commercial Acetylene was a company that was purchased for the benefit of the oxy-acetylene business and as a matter of courtesy they were allowed to continue as they were—maybe convenience and courtesy. Magnolia Airco Gas Products and the Pure Carbonic of Texas were never included in the agency agreement because it is so difficult for a large company to get into Texas and qualify, and so expensive, too, and there was a great deal of pride on the part of the originators of the projects in Texas in keeping the company in their own hands. Again, we conceded the point and let them run their own business under general direction of Air Reduction Sales Company.

Q. Now, you explained yesterday during your direct examination the process of extracting oxygen. I don't recall that you covered the process of extracting carbonic acid gas.

A. Well, carbonic acid gas is the product of combustion, and most every chimney in the world is spilling out carbonic [fol. 102] acid gas. But it isn't always practicable to redeem it. So there are a number of different ways of——

Q. Well, I am inquiring as to the method that was used by the carbonic companies that we are interested in here—Pure Carbonic, Inc., and Pure Carbonic, Inc., of America.

A. Well, there were some coke plants, where coke was

burned up; there were some oil plants where oil was burned. There were some plants—and those were the most important—where the carbonic acid gas coming off a process of fermentation, say, as in alcohol plants, was redeemed.

Q. Does that process have anything to do with the process of extracting oxygen from the air?

A. Not anything.

Q. Entirely different?

A. Well——

Q. Separate and distinct?

A. Entirely different, yes, sir.

Q. How about the containers, the cylinders?

A. The containers are exactly the same type of containers.

Q. Are they as heavy?

A. Yes, sir; in proportion.

Q. Well, you say in proportion. How heavy are they?

A. Well, there are small cylinders used in the carbon dioxide business—smaller cylinders used in the carbon dioxide business than are commonly used in the oxygen business.

Q. What number of cubic feet does a cylinder contain?

A. Usually 50 feet.

Q. 50 feet?

A. 50 pounds, I mean.

Q. Well, you say 50 pounds. Do you mean the weight of the cylinder?

A. No. I mean the weight of the gas.

Q. How much would the cylinder weigh?

A. I don't know.

Q. Much lighter than what did you say, 150 pounds for the oxygen cylinder?

A. 130 pounds for a 220 cubic foot oxygen cylinder.

Q. And how does the carbonic cylinder compare with that?

A. I don't know.

[fol. 103] Q. You are not acquainted with that?

A. I don't know the weight of a carbonic cylinder, either a 50-pound or a 20-pound cylinder. I do happen to know the weight of a 220-foot oxygen cylinder.

Q. Have you seen the carbonic cylinder?

A. Oh, yes.

Q. Well, in appearance is it considerably smaller than the oxygen cylinder?

A. Smaller than what?

Q. The oxygen cylinder. Does it appear smaller?

A. I beg your pardon?

Q. Does it appear smaller than the oxygen cylinder?

A. The 220-foot oxygen cylinder is considerably larger than a 50-pound carbonic—than a 50-pound carbon dioxide cylinder, to the eye.

Q. Now, were your plants that manufactured carbonic acid gas located contiguously to the plants that manufactured oxygen gas?

A. No, I don't think so, in any case.

Q. Were they widely separated?

A. They were widely separated, yes, sir.

Q. Now, did you distribute your product—that is restricted to the oxygen—did you distribute your product to the user of the gas?

A. Speaking of oxygen?

Q. Yes.

A. Yes, sir.

Q. You didn't distribute through a wholesaler?

A. Not as a general rule.

Q. Is that also true of carbonic gas?

A. Yes, sir.

Q. Direct to the user?

A. Direct to the user.

Q. What about the carbide? How was that distributed?

A. Well, carbide was sold direct to the user, too. Such of the carbide that we produced as was not used in our own acetylene plants.

[fol. 104] Q. Now, the Wilson Welder products, the electric welding equipment, was that distributed by the company to the user?

A. Yes, sir.

Q. To the user of the equipment?

A. Yes, sir.

Q. Do you recall Petitioner's Exhibit 8, the supplemental contract of August 1, 1936, between Air Reduction Company and National Carbide Corporation?

A. The supplemental agreement?

Q. Yes.

A. Yes, sir.

Q. Can you tell me why this agreement was entered into? I mean specifically why was the agreement of August 25, 1922, that had existed between National Carbide Corpora-

tion and National Carbide Sales Company supplemented and extended?

A. The original agreement in 1922 was a marketing agreement only. The supplementary agreement made the relation between the two companies parallel with the standard relation, and the Carbide Company was then an operating company as well as a selling company.

Q. Now, you will recall Petitioner's Exhibit 15, which deals with the Wilson Welder and Metals matter, and I refer you to the last paper in this exhibit folder, and the last paragraph. That would be the letter on Wilson Welder and Metals stationery and it is directed to Air Reduction Company, and I will ask you to examine that and tell me what occurred with reference to that letter.

A. Well, I can't give the detail of the performance.

Q. Well, I will ask you a few questions.

A. But certainly the agreement set forth here was carried out by Air Reduction Company, Inc.

Q. Well, now, I understood that during your direct examination you said that on the reduction of capital stock of Wilson Welder and Metals Company their assets were transferred to Air Reduction Company; isn't that correct?

A. I believe that is so, yes.

Q. Now, in accordance with that paragraph, that statement states they were immediately turned back, does it not, by Air Reduction Company to Wilson Welder?

[fol. 105] A. They were to be turned back, this paragraph says.

Q. Now, as a matter of fact, were any assets transferred, or wasn't it a matter of book entries on books?

A. To Wilson Welder, you mean?

Q. Yes.

A. I believe they were transferred, yes, sir, because Wilson has been operating ever since.

Q. Well, by virtue of the statement in that paragraph, and carrying out that provision Wilson Welder and Metals Company continued as it had before, didn't it, with the same assets?

A. No, because there were some assets that were involved in the partial liquidation of Wilson Welder and Metals, bringing it down to the bare bones of one of our operating companies.

Q. What assets were transferred out of the company?

A. That I wouldn't know, because I didn't have anything to do with it.

Q. Would the book records disclose that?

A. They presumably would.

Q. Who would be familiar with those records?

A. The financial end of the business.

Q. Pardon?

A. The financial accounting end of the business.

Q. Now, the matter of securing authorization for expenditures in excess of $500: to what particular type of expenditure does that provision or that policy pertain?

A. Well, largely capital expenditures or expenditures for war material for processes of manufacture, such as, for example, brass, copper, and steel, for the operation in Jersey City, where they make torches.

Q. What company is that in Jersey City that you mentioned that makes torches?

A. That is Air Reduction Sales Company?

Q. How about expenditures in the ordinary course of business, such as salaries, for instance, or wages?

A. Salaries are controlled on a budget basis. They have nothing to do with the appropriation system.

Q. Well, would it be correct to say that the limitation of expenditures to $500 without the authorization applied to capital expenditures?

[fol. 106] A. No. It isn't as you may have inferred from what I said yesterday, it isn't the case of there being no control on sums under $500. There is a feature of the appropriations system that takes care of figures down to practically nothing, $50, or something like that. May I rehearse that a little bit? Do you want me to go over it with you?

Q. Surely, I would like to understand it.

A. Well, a man in the field, and in charge of a business there, may, at his own discretion, in an emergency, spend $50. That is the top limit that he may spend without some form of appropriation request and appropriation granted. Now, in between the $50 emergency expenditure that he may make at his own discretion, come a series of what you might call appropriations. They were known in our organization as CPO's and CMBO's. The latter is the more important, so I will deal with that. The CMBO is a construction, maintenance, betterment order. And that had to go through the machinery of an appropriation except

that it did not go to the Board of Airco. It was finally O.K.'ed by an executive officer of Airco.

The same thing with the CPO, which is a construction—well, I have forgotten what it is now, but, anyway—construction production order, that is it. That was another form of appropriation comparable to the regular appropriation but ranging, in its figures, from $50 up to $500.

Mr. Maddox: I have no further questions.

Mr. Wilson: I have no redirect, your Honor.

The Court: You may be excused.

(Witness excused.)

Mr. Wilson: Perhaps your Honor might like to see a copy of Petitioner's Exhibit 23, which was entitled "Air Reduction Company, Inc., Officers of Air Reduction Company, Inc., and agency companies, during 1938."

The Court: Yes, thank you.

Mr. Wilson: It bears, of course, upon the point which we made of the substantial identity of the officers and directors of these companies.

I will call Mr. Van Fleet.

(Tr. 208-242.)

[fol. 107] HERMAN VAN FLEET, a witness on behalf of the Petitioners, was duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Mr. Van Fleet, what positions do you now occupy with Air Reduction Company and any one or more of the four subsidiary companies?

A. I am vice president and operating manager of Air Reduction, Inc., and Air Reduction Sales. I am a director of Air Reduction Sales, Pure Carbonic, Inc., and Wilson Welder and Metals Company.

Q. And did you occupy those positions throughout the year 1938?

A. I did.

Mr. Wilson: I am going to take up now the second branch of the operations of Air Reduction Company as they appear on the organization chart.

By Mr. Wilson:

Q. Mr. Van Fleet, were you in charge of this operations branch of the Airco organization?

A. I was.

Q. As operating vice president and manager in charge of that branch, will you tell us your functions?

A. There were eight departments. May I refer to a little memorandum that I have?

Q. Yes; you may refer to anything that will refresh your recollection on these details.

A. There were eight departments.

Mr. Wilson: May I hand the witness a copy of this chart that is already in evidence?

The Court: Surely.

A. Reporting to me were two assistant vice presidents, E. C. Turner and R. A. Sossong. Mr. Turner was assistant vice president of Air Reduction Company, Inc., and Air Reduction Sales Company. Mr. Sossong was assistant vice president of Air Reduction Company, Inc., assistant vice president and manager of gas plants of Air Reduction Sales Company. He was also a vice president of Pure Carbonic Company.

[fol. 108] By Mr. Wilson:

Q. Before you go into further detail of that general nature, Mr. Van Fleet, will you tell us what the general scope of your function was as operating manager of these plants?

A. I had charge of the engineering which involved the design and construction and maintenance of plants.

Q. And with respect to what company or companies did you perform that general function?

A. With respect to all companies.

Q. When you say "all companies," will you just enumerate them for me, please?

A. With respect to Air Reduction Sales, Pure Carbonic, National Carbide, Wilson Welder.

Q. Now, what were the departments that were under your supervision? Will you just list those for us?

A. The engineering department under the chief engineer, the apparatus manufacturing plant, under a manager; the inspection department, under a chief inspector, the apparatus research and development department, under a manager, the engineering research department, under a manager, the operation of oxygen, carbon dioxide, in fact, all gas plants and ice plants, under a general superintendent; the operation of acetylene plants, under a general superintendent, and the operation of an acetylene cylinder manufacturing plant under a manager.

In addition, I had an assistant to the vice president who worked under special assignment.

Q. And who was that throughout the year 1938?

A. J. H. Allen.

Q. Now, one of those departments that were under your supervision was the engineering department; is that right?

A. That is right.

Q. And that, as appears from the chart, was supervised by E. C. Turner who was an assistant vice president of Air Reduction Company, Inc., and also of the Sales Company; is that right?

A. Yes.

Q. Who was the chief engineer of that department?

A. J. E. Fricker.

[fol. 109] Q. And was he accountable or did he report first to Mr. Turner and then through Mr. Turner to you?

A. That is right.

Q. Now, will you tell us briefly what the functions of this engineering department, under your supervision, were?

A. They had charge of the design of buildings and their construction, the design of mass concrete, and its construction. They had charge of mechanical design of equipment. They had charge of the installation of plant equipment, and they also had charge, in cooperation with the plant operating department, of maintenance.

Q. For what company or companies did that department perform those functions?

A. For Air Reduction Sales, for National Carbide, Pure Carbonic, Wilson Welder.

Q. Can you give us an illustration or two of the type of thing that that department has done, for one or the other of those companies?

A. For any of the companies, if a building or buildings

were to be built, this department designed the building and had charge of the construction. It was the same in regard to the design of mass concrete. When I say mass concrete I mean reinforced concrete construction.

Q. You also had under your supervision the matter of operating the gas plants; is that right?

A. Yes.

Q. And that, as appears on this chart, was directly supervised first by Mr. Sossong who was an assistant vice president of Air Reduction Company, an assistant vice president and manager of gas plants of Air Reduction Sales Company, and vice president of Pure Carbonic; is that correct?

A. Yes.

Q. Will you tell us the functions of this gas plant department under Mr. Sossong, who, I understand, then reported to you; is that correct?

A. Yes.

Q. Branches of the gas plant operation came within the scope of Mr. Sossong's supervision?

[fol. 110] A. Those gas plants manufacturing oxygen, hydrogen, nitrogen, carbon dioxide—both gas and liquid and solid—and the rare gases, under a general superintendent, Mr. C. J. Andrew. The acetylene plants, where acetylene was generated from carbide, were under the direction of a general superintendent, Mr. H. W. Hill, and the acetylene cylinder manufacturing plant was under a manager, Mr. C. A. Wallin. All three of these men reported to Mr. Sossong.

Q. Yes. Now, first, the department which you have just mentioned for the operation of oxygen, nitrogen, hydrogen, and the other gas plants. Was that under Mr. Andrew?

A. Yes.

Q. And was he the general superintendent of those plants?

A. Yes.

Q. And the plants of what company came under his supervision?

A. All of what we call the plants manufacturing compressed gases, that is, the oxygen plants, the carbonic plants, and the rare gas plants—that it, the plants producing argon, neon, krypton, and so forth, the rare gases.

Q. In some cases was there a joint use of gas plants?

A. Yes.

Q. Just tell us about that in your own way, Mr. Van Fleet.

A. At Atlanta, Georgia, and Neville Island, Pennsylvania, where are located two acetylene plants, these plants were also used by the Pure Carbonic Company in the production of carbonic gas.

Q. And was that true during the year 1938 and at other times?

A. Yes.

Q. Was there any further joint use of plants in other aspects of gas plant operation of the business?

A. There were a number of adjacent plants used by Pure Carbonic; Buffalo——

Q. Before you get to that: were these oxygen plants used by Pure Carbonic and some other company?

A. Well, of course, all of these oxygen plants were at locations where we had what we call district stores.

Q. Yes.

[fol. 111] A. And the products of Wilson Welder, Pure Carbonic, Air Reduction Sales, were all warehoused at those points.

Q. Well, what I am getting at is this: I am asking you about the joint use of other plants, and I would like to know what companies, if any, jointly used these other plants about which you were speaking.

A. Pure Carbonic, Inc., used eight oxygen plants.

Q. Yes. Well, will you tell us where those plants were located?

A. Buffalo, Cincinnati, Huntington, West Virginia, Harrisburg, Pennsylvania, Louisville, Kentucky, Milwaukee, Wisconsin, Minneapolis, Minnesota, New Orleans, Louisiana.

Q. Now, were there other illustrations in your plant operations of joint usage?

A. At Deep Water, Maryland, across the river from Wilmington, Delaware, where dry ice is made by Pure Carbonic. We have a nitrogen plant operated by Air Reduction Sales.

Q. And when you listed those other eight places, or locations of joint usage, you said, as I understood it, that oxygen plants were jointly used by Pure Carbonic; is that right?

A. Yes.

Q. Now, those oxygen plants: by what company were they operated, or under what supervision?

A. Air Reduction Sales.

Q. So that was an illustration of the joint use of plants, was it, by Air Reduction Sales, and by Pure Carbonic?

A. Yes.

Q. Now, still dealing with these departments that came directly under Mr. Sossong's supervision, one of those was a department for the operation of acetylene plants; is that right?

A. Yes.

Q. And, as appears from the chart, was that under the supervision, the immediate supervision, of H. W. Hill, general superintendent of acetylene plants?

A. It was.

Q. And did Mr. Hill report to Mr. Sossong, and, through him, to you?

A. Yes.

[fol. 112] Q. Can you tell us the approximate percentage or proportion of calcium carbide which was transferred during the year 1938 from the National Carbide Corporation to the Sales Corporation?

A. It was approximately 48 percent.

Q. And what did the Sales Corporation do with that calcium carbide?

A. We generated acetylene from it.

Q. And was any other disposition made of a portion of the calcium carbide so transferred, so far as you recall?

A. Some of the carbide was sold to customers who generated their own acetylene in privately owned acetylene generators, for use with oxygen in the acetylene welding and cutting, in their own businesses.

Q. Did that refer to a certain portion of the calcium carbide which was transferred from the National Carbide Corporation to the Sales Corporation?

A. No, that carbide was not included in the 48 percent. We used, in our acetylene plants, 48 percent of the carbide produced by the Carbide Company.

Q. Now, also reporting to Mr. Sossong and, through him, to you, as appears from the chart, was a department for the operation of cylinder manufacturing plants; is that right?

A. Yes.

Q. And throughout 1938, under whose direct charge was that particular department?

A. Mr. C. A. Wallin.

Q. Just tell us briefly what that department did.

A. One of the problems in handling acetylene gas is to

package it. Acetylene gas is an explosive gas, and it isn't safe to simply compress that in a cylinder. It is necessary to dissolve the acetylene in a solvent such as acetone, and, in turn, to have that acetone completely diffused throughout a porous mass. Therefore, a manufacturer of an acetylene cylinder has to fill a steel cylinder with a porous mass, and then pump acetone, the solvent for the gas, into the porous mass. Given that preparation, then, acetylene can be compressed into the cylinder.

Q. Which one of these subsidiary companies had charge of the operation of this cylinder manufacturing plant?

[fol. 113] A. Air Reduction Sales Company.

Q. And what happened to the cylinders manufactured at that plant after they had been produced at the plant?

A. Do you mean from the standpoint of ownership?

Q. Yes; if you know.

A. They were transferred to Air Reduction, Inc.

Q. Now we move along to another department, which I understood you to say was under your supervision in 1938, Mr. Van Fleet: the department for the operation of apparatus factories, and general stores,

A. Yes.

Q. Was that one of those departments under your supervision?

A. Yes.

Q. By whom was that supervised in 1938, directly?

A. That was supervised directly by D. M. Hasbrouck.

Q. And what type of equipment did the apparatus factory make?

A. We manufactured there the tools and appliances used in the application of compressed gases. That is, for oxygen and acetylene, we manufactured many kinds of torches, different sizes for different purposes, both for welding and cutting. We manufactured the regulators, or reducing valves—that is the devices that are employed to take the gas compressed from the cylinder and to deliver it through small hose lines to the torches.

Q. Yes.

A. We manufactured acetylene generators, which we sold to our customers, and also made for use in our own plants. We manufactured welding and cutting machines for mechanical applications. We also had, as a part of that department, a general stores.

Q. Well, now, before we get to general stores, this apparatus which you have been describing for us in the last minute or two—what companies used the type of apparatus you mentioned?

A. We also manufactured there apparatus for the Pure Carbonic Company.

Q. Yes.

A. And at times did work for Wilson Welder.

[fol. 114] Q. And were those the two companies which used the type of apparatus you have just been describing to us?

A. Well, the Pure Carbonic Company used a gas type of apparatus, for instance, reducing valves. Wilson Welder Company, being a company engaged in electric welding pursuits, is a rather different application from the gas welding application of welding and cutting.

Q. Did you produce apparatus for both those companies?

A. Yes.

Q. Now, you were going to tell us about general stores, which I notice from the chart appears to have been under the immediate supervision of Mr. D. M. Hasbrouck, in 1938. Will you just tell us how this general stores operated?

A. We have at Jersey City, where also is located the apparatus manufacturing plant, a general stores department, where we carry in inventory in the warehouse tools and appliances that we sell to our customers, the trade in general, and where we also warehouse machinery and spare parts for such machinery, that is employed in the manufacture of our products.

Q. Of what products in particular, if they are in particular?

A. Oxygen, nitrogen, hydrogen, argon, the rare gases.

Q. Are you speaking of Airco products generally?

A. Yes; I am speaking of all the so-called compressed gases, including the rare gases—neon, krypton, and so on.

Q. Yes.

A. Acetylene, carbonic gas. We also warehoused there some materials that we purchased as supplies, operating supplies, some materials that we purchased for resale to our customers, such as welding rods and fluxes. Well, we made fluxes; but that is in another department.

Q. Now, on behalf of what company or companies did this general stores that you have been describing function throughout the year 1938?

A. In behalf of all companies, that is, Air Reduction Sales, Pure Carbonic, Wilson Welder somewhat, National Carbide very little, because they had a limited number of plants, and it was more convenient and efficient to warehouse at those plants for them.

[fol. 115] Q. Were there certain district stores located throughout the country in 1938? We are always talking primarily of 1938, Mr. Van Fleet, you understand that, do you not?

A. Yes. About 26 district stores were established throughout the United States, where we warehoused, under the control of general stores, products, materials, supplies, apparatus, used in the application of gases, where we held, as inventory, such items for distribution to our customers.

Q. And for what company or companies did these district stores function? Can you tell us about that in a general way?

A. For the Air Reduction Sales, for Pure Carbonic, and for Wilson Welder.

Q. What was the relation between these district stores to what you have designated as general stores?

A. The district stores were under the supervision of our general storekeeper, at Jersey City, and our general storekeeper determined the amounts of inventory that each store would carry. And if there was a dispute, I usually settled it.

Q. In other words, all this operation, among others, finally headed up to you; is that right?

A. Yes.

Q. Now, I notice from the chart that there was another department under your supervision, known as the apparatus inspection department; is that correct, in 1938?

A. Yes.

Q. And in 1938, who had the immediate charge of that department?

A. W. E. Mock.

Q. And, as appears from the chart, did Mr. Mock, who is designated here as chief inspector, report directly to you?

A. Yes.

Q. Now, on behalf of what company or companies did his particular department function?

A. His department functioned as the inspection authority of the goods and appliances that we manufactured ourselves at our Jersey City apparatus manufacturing plant. His department functioned to inspect materials that we purchased,

materials to be used as supplies, operating supplies, in gen-
[fol. 116] eral. His department also inspected materials that were purchased for resale to our customers.

Q. Can you tell us also, in this connection, with respect to what particular companies this apparatus inspection department functioned?

A. It functioned on materials for Air Reduction Sales, Pure Carbonic, Wilson Welder, and Metals.

Q. Now we move along to another department which I see listed here. Did the department known as the apparatus research and development department come under your general supervision in 1938?

A. Yes.

Q. And by whom, in 1938, was that department directly supervised?

A. By Mr. J. J. Crowe.

Q. And did Mr. Crowe report to you?

A. Yes.

Q. I notice that he is designated on the chart as the manager of that department; is that right?

A. Yes.

Q. Will you tell us briefly what the functions of that department were, and for what company or companies that department functioned?

A. That department was the department where we conducted research and development of the methods and processes employed in the application of oxygen and acetylene, to welding and cutting. They developed there the first models of torches, regulators, acetylene regulators—in general, all the manual tools and appliances used with the gases that we manufactured. For all of the compressed gases, the oxygen, hydrogen, nitrogen, argon, and so on, as manufactured by Air Reduction Sales Company, for acetylene gases as manufactured by Air Reduction Sales, for Carbonic gases, as manufactured by Pure Carbonic, Inc. That department also studied betterments in many ways, that is, the betterment of apparatus, the betterment of methods, and was responsible for the future methods and apparatus that were being studied.

Q. Would it be true to say that department functioned for the entire Airco organization?

[fol. 117] A. It actually did do work for Air Reduction Sales, for Pure Carbonic, for Wilson Welder. I think it was called upon to do little or nothing for National Carbide.

The work we did there was done in the engineering department, in general, that is for National Carbide, in design and construction, by Mr. Turner, who was a specialist in carbide furnace work, and work of that nature.

Q. Now, the next department which I notice on the chart here is the department known as the engineering research department. Under whose supervision was that in 1938?

A. Under the supervision of Mr. J. L. Anderson.

Q. And, as appears from the chart, did he report directly to you?

A. He did.

Q. Will you tell us, with reference to that engineering research department, what its functions were and for which of these companies those functions were performed?

A. The engineering research department had to do with those methods and that equipment that was done mechanically—that is, not by hand, but either automatically or semi-automatically accomplished by machine, both for welding and cutting with oxygen and acetylene methods and processes of mechanical welding and mechanical cutting, where a machine was operated by push button, for instance, and all the events were controlled that way. They also developed cutting machines for the cutting of steel and ferrous metals in general, used very extensively by shipyards, steel companies, and so forth.

Q. Was there a research laboratory maintained under the general supervision of this department?

A. There was.

Q. Where was that located?

A. At Jersey City, New Jersey.

Q. And did that laboratory perform research services for various of the companies?

A. It performed research services for Air Reduction Sales, for Wilson Welder, for Pure Carbonic.

Q. And to what phase of operation or activity were these particular research services devoted? What I have in mind [fol. 118] is a possible distinction between engineering and chemical research. I understood there was a chemical research department.

A. Oh, yes. There is a difference between apparatus research and engineering research as compared to chemical, physical, and liquefaction research.

Q. Was that latter type of research under a different branch of Airco operation?

A. Yes, it was.

Q. Now, did the engineering research department have anything to do with shop installation for customers of Airco?

A. Yes, the department developed mechanical welding equipment. For instance, the special pipe and tubing was made by oxy-acetylene welding methods. For instance, ammonia piping. All the ammonia piping made by the National Tube Company was made through a process developed by members of that department. Members of that department would go to the plants of customers to install equipment, a part of which equipment had been purchased from us, a part from others, which, together, made up a complete installation to produce piping or tubing, as the case might be. They usually engineered that plant for our customer, advised him as to purchases of equipment that we were not furnishing, and assisted them in the installation, and usually engineered the acetylene generating installation and supervised its construction and installation.

Q. In other words, that type of shop installation for customers was rendered for several of the subsidiary companies?

A. It was rendered for Air Reduction Sales, to a lesser extent for Pure Carbonic and Wilson Welder—more advisory than actively done in the field.

Q. In the year 1938, and at other times, were certain important policy matters in connection with the Airco organization handled by broad Airco committees?

A. Yes.

Q. Will you tell us what those committees were?

A. There was an apparatus committee, of which I was chairman.

Q. Yes. Will you just give us the names of the others, first.

A. There was a process and production, control committee.

Q. Well, now, first, as to the apparatus committee, how was the membership of that committee made up?

[fol. 119] A. The apparatus committee was made up of representatives of the sales department of agency companies, Air Reduction Sales Company—it is a little difficult. Are you confining this to 1938?

Q. Yes.

A. The Wilson Welder Company or the Pure Carbonic, were either represented regularly or by request.

Q. Yes.

A. If something was coming up concerning them, that is.

Q. And what position, if any, did you occupy on the committee in 1938?

A. I was chairman of that committee. We also brought to that committee the production end of any of these companies, the engineering end, as the case might be, or the selling or purchasing end, to determine what projects would be assigned to the apparatus research or the mechanical research for study or development, the committee being concerned with not only devices but to a considerable extent methods and processes for the application of the gases.

Q. And on behalf of what company or companies did that committee function?

A. Air Reduction Sales Company, Pure Carbonic, Wilson Welder.

Q. Now, you referred a few moments ago to another committee having to do, I believe, with production and control.

A. Yes.

Q. Did that committee exist in the year 1938 and throughout the year 1938?

A. Well, a committee existed in 1938. It was a production committee. We determined the amounts of the items that were to be manufactured by our apparatus manufacturing plant, the quantities of such—we determined the items themselves, the quantities of such items, we determined the quantities of materials that would be purchased for resale to our customers, such as welding rods, and so forth. We also passed upon the production schedule for all machinery to be used by our producing plants of Air Reduction Sales, Pure Carbonic, and, to a more limited extent, Wilson Welder.

[fol. 120] Q. How was the membership of that committee made up, in 1938, and at other times?

A. Representatives of all the companies concerned—that is Air Reduction Sales, Pure Carbonic, Wilson Welder.

Q. And what position did you occupy on the committee?

A. I was chairman of that committee.

Mr. Maddox: Just a minute. Did you include in that group representatives of Sales, Welder, Carbonic and also Carbide?

The Witness: No, I didn't include Carbide in that committee. Occasionally we were asked for opinions, but I

wouldn't say that the committee passed upon the Carbide problems as we did on the gas problems of the companies. These problems were passed upon by the engineering department.

By Mr. Wilson:

Q. Can you give us any explanation of how it came that the Carbide matters were in a certain, let us say, excepted category so far as the operation of that committee was concerned?

A. Well, to begin with, there was one carbide plant, at Ivanhoe, Virginia. That company was handled from New York by Mr. Keely and there being only one plant at the start, it was obvious that the questions of stocking materials, the questions of raw materials, such as limestone and coke, from which carbide is made, the question of construction, and so on, or questions of technical problems, were easily handled through the one simple organization. There wasn't the problem of coordination of a large number of plants and activities.

Q. Yes. Can you tell us something about the general problem of varying calcium carbide production? Is it a difficult one or a comparatively easy one?

A. No, it is a comparatively easy one. There was a backlog of requirement for carbide occasioned by the operation of our acetylene manufacturing plant, and the sale of carbide to our customers, and carbide being produced in electric furnaces, it was feasible to operate a different number of furnaces. As the tonnage varied, it was feasible to have a reasonable inventory of carbide in warehouses at Ivanhoe and in district stocks, so that it was feasible to operate the carbide company on what you might call day to day orders. [fol. 121] Q. Have you told us about another committee which I understand was called the process applications committee?

A. The process applications committee was a committee that authorized projects for research and development.

Q. Before you go further, was that committee in existence throughout 1938?

A. It was.

Q. And how was the membership of that committee comprised?

A. It was comprised of representatives of the Sales Company, Pure Carbonic, Inc., Wilson Welder.

Q. Will you just tell us what the functions of that committee were in 1938 and at other times?

A. That committee considered the projects for research and development, for those three companies. It also considered, as brought to it from time to time, by the various representatives, the needs of these companies in regard to products—either existing products or products that were desired.

Q. Did that committee have anything to do with the matter of applying for patents?

A. That committee had the authority and duty to recommend those subjects or those inventions for which application for patents would be made, and also they passed upon patented inventions that were being considered for purchase.

Q. And for what company or companies did it perform those functions?

A. For the Sales Company, Pure Carbonic, Wilson Welder.

Mr. Wilson: Now, I think maybe yesterday I may have gone a little off on the composition of air. I think we ought to have an expert on the subject correct our scientific knowledge on that point.

By Mr. Wilson:

Q. Will you tell us the relative percentages of oxygen and nitrogen and these other gases in air?

A. I think the least confusing way to put it is that oxygen comprises about one-fifth of the atmosphere, and nitrogen about four-fifths. That argon comprises less than 1 percent, and all of the other rare gases less than one-half of [fol. 122] 1 percent. So that with oxygen as one-fifth, nitrogen four-fifths, and one and a half percent mixed in there of the rare gases, that really gives you the composition of the atmosphere.

Mr. Wilson: I must say I am somewhat embarrassed your Honor. I think I got nitrogen and oxygen turned around yesterday.

Mr. Maddox: May I ask a question of this witness?

The Court: Yes, sir.

Mr. Maddox: Are you a physicist or a chemist?

The Witness: I am a mechanical engineer, and have spent, since 1909, in the pursuit of industrial chemistry.

Mr. Maddox: Industrial chemistry?
The Witness: Yes, sir.
Mr. Maddox: Did you study chemistry?
The Witness: Yes, sir.
Mr. Maddox: In what school?
The Witness: Cornell University.
Mr. Maddox: Did you graduate there?
The Witness: 1907.
Mr. Maddox: Did you graduate?
The Witness: Yes, sir.
Mr. Maddox: And did you practice chemistry?
The Witness: Yes, I have practiced mechanical engineering. I didn't practice professional chemistry.

* * * * * * *

Cross-examination.

By Mr. Maddox:

Q. Mr. Van Fleet, did you attend any other schools besides Cornell?
A. No university. No other university.
Q. Did you graduate in engineering?
A. Yes, sir.
Q. Did you get a degree in engineering?
A. A degree in mechanical engineering.
Q. Did you get a degree in chemical engineering?
A. No.
Q. Do you have a copy of the chart before you, Petitioner's Exhibit 22?
A. I believe it is, yes, sir.
[fol. 123] Q. When was this chart made up? Do you recall?
A. No.
Q. Was it in existence in 1938?
A. It was.
Q. And I suppose prior to 1938?
A. Yes.
Q. Was a similar chart made up for each year?
A. We made charts up from time to time. I don't think we deliberately made a chart up for each year.
Q. Can you tell me where the committees you mentioned appear on the chart?
A. They don't appear on the chart.

Q. Can you tell me why?

A. No.

Q. Referring to the chart which you followed very closely in your direct examination, I refer you particularly to the point in the center there, under Mr. Mock's name. It says "Inspection apparatus, Sales Company, and Pure Company." Now, what do Sales Company and Pure Company stand for in that instance?

A. Air Reduction Sales Company, Pure Carbonic Company.

Q. And what is the significance of those names under that particular designation there?

A. Why, to me, the significance is that he performed services for both companies.

Q. Is that true wherever that appears? Wherever that designation appears? That is, wherever "Sales Company and Pure Company" appear, it indicates that the individual performed services for both companies?

A. Yes; I believe so.

Q. And this may be repeating, but Pure Company means Pure Carbonic Company, Inc?

A. Pure Carbonic Company, Inc.

Q. Now, you spoke of joint use of gas plants in Atlanta, Georgia, and a place in Pennsylvania, New Island, was it?

A. Neville Island, a place below Pittsburgh.

Q. Neville?

A. Neville. N-e-v-i-l-l-e.

[fol. 124] Q. Two plants?

A. Two plants in all.

Q. One at Atlanta and one in Pennsylvania?

A. Yes.

Q. And those were acetylene plants?

A. Yes; primarily.

Q. Just how were they used for the production of carbonic acid gas?

A. A part of the housing, a part of the general facilities. The general supervision.

Q. Well, was it the same apparatus?

A. No.

Q. Separate and distinct apparatus?

A. Separate and distinct apparatus.

Q. But it happened to be in one building?

A. It happened to be in one building, under the same supervision.

Q. I see. Now, who was it that the acetylene was manufactured for in the portion of the building where the acetylene was manufactured?

A. Air Reduction Sales Company.

Q. And carbonic gas?

A. Pure Carbonic, Inc.

Q. And that was true of both those plants?

A. Both, yes.

Q. Now, you mentioned eight oxygen plants, which were jointly used, I assume, between Sales Company and Pure Carbonic; it that true?

A. Yes.

Q. And is the situation with reference to the eight the same as with the two: That is, that the facilities for manufacturing oxygen did not also manufacture the carbonic acid gas?

A. Under the same supervision, under the same technicians.

Q. But with different apparatus?

A. But with different apparatus.

Q. And the oxygen was manufactured for Sales Company?

A. Yes.

Q. And the carbonic acid gas for Pure Carbonic?

A. Yes.

[fol. 125] Q. And that was true in each of these eight plants?

A. Yes. There is a very similar technique in the handling of high pressure gases.

Q. Is the situation similar at Deep Water, Maryland, where you manufactured dry ice, and also have a nitrogen plant?

A. Yes.

Q. Is the manufacture of dry ice and nitrogen one operation, or is one a by-product of the other?

A. No. They are manufactured in separate apparatus under the same supervision of the same superintendent. Both high pressure gas problems.

Q. With reference to the carbide, as I understand it, 48 percent of National Carbide's product is turned over to Air Reduction Sales, and that goes into the manufacture of acetylene?

A. Yes.

Q. And the balance, 52 percent, of carbide manufactured by National Carbide, is sold by them to outside sources?

A. It was sold by them and by Air Reduction Sales, both.

Q. Can you give me the percentages of the 52 percent that were sold by Air Reduction Sales and by National Carbide?

A. No, I can't give you those percentages.

Q. Would it be slight for Air Reduction Sales?

A. No, it would be appreciable for Air Reduction Sales.

Q. And how was the transfer made between the two companies, between National Carbide and Air Reduction Sales? At cost?

A. At cost.

Q. How was cost determined?

A. Well, you are in a territory now that was outside my jurisdiction, and I doubt if I am competent to give you the bookkeeping on that.

Q. But it is your understanding that it was attempted to transfer it at cost, without profit?

A. Yes. I know in the case of apparatus manufactured, which was a plant under my supervision, that the apparatus was transferred to the Sales Company at cost of sales.

Q. I refer again to the chart. You have here, under your supervision, a chief engineer, and then you have an engine-
[fol. 126] ering research department. Can you distinguish between those two, just what the difference is there?

A. Yes; the engineering department, under the chief engineer, had to do with the design of structures, buildings, with the design of plants as a whole, with the construction of buildings, and the installation of equipment, with the design of plant machinery, such as oxygen compressors, with the design of liquefaction equipment, such as oxygen stills.

Q. Well, maybe I can shorten this up a little. The chief engineer, then, functioned in connection with the construction of plant and equipment for the manufactured product, whereas the engineering research was for the purpose of developing product for sale?

A. Yes, and equipment used in the application of our products.

Q. How do you distinguish between the last two there, apparatus research and development, and engineering research?

A. The apparatus research and development had to do with the manual applicances, the hand tools, of the art.

Q. In that connection, you mean those tools that were used for the——

A. Such as torches.

Q. In connection with the gases?

A. Regulators, yes.

Q. Whereas the other was with reference to——

A. Machine equipment, machine tool equipment.

Q. Such as is found in the Wilson Welder?

A. Yes, or to a greater extent in Air Reduction Sales, the welding and cutting machines that were mechanically semi-automatic or virtually automatic.

Q. Using gas for the——

A. Yes, using gas—using oxygen and acetylene for welding and cutting.

Q. Take Mr. Andrews' department there, general superintendent of oxygen and carbon dioxide plants. That is the manufacure of your gas department, is it not?

A. With the exception of acetylene, which was in another department.

[fol. 127] Q. And the oxygen, hydrogen, nitrogen were manufactured, were they not, together with the rare gases, for Air Reduction Sales?

A. Oxygen, hydrogen, nitrogen, and rare gases, for Air Reduction Sales, yes.

Q. And the carbon dioxide and dry ice for Carbonic?

A. For Pure Carbonic.

Q. Yes. And the next, acetylene plants, that was for Sales Company?

A. Yes.

Q. When did the company start manufacturing acetylene cylinders?

A. Many years before 1938.

Q. Is there any explanation why they manufactured acetylene cylinders and not other cylinders that were used?

A. Yes. In the early days of acetylene production there was no place to go to buy containers. Acetylene was first compressed in ordinary open cylinders like an oxygen cylinder, that is cylinders with no filler, and some pretty bad accidents occurred. All of the characteristics of acetylene were not understood, and we were able to profit by the experience that was obtained in our operation in the

early days of production of acetylene in the United States, we realized that we could not use the ordinary open cylinder, and that we would have to manufacture a container, and a container was developed by experimental means that we manufactured for our own use.

Q. You mentioned that in 1938 there was only one carbide plant, and that was at Ivanhoe, Virginia.

A. No. I was asked the question, as I understood it, as to why we handled the Carbide Company in a different way than some of the other companies, by permitting the Carbide Company to handle a large part of its own affairs. I said that in the beginning we had only one carbide plant. We had more than one carbide plant in 1938, however.

Q. Well, I understood your testimony to be that because they only had one plant, that they were permitted to operate, we might say, with less supervision.

A. Not with less supervision.

[fol. 128] Q. By the Airco Company, that is.

A. Let me put it this way: in the beginning they had one plant. As the years went on and the industry developed, and greater quantities of carbide were required, other plants were added. In 1938 there were two carbide plants, which was still a simple problem from the standpoint of coordination.

. . . . . .

(Tr. pp. 243-277.)

CHARLES D'W. GIBSON, a witness called on behalf of the Petitioners, was first duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Mr. Gibson, what position do you occupy in Air Reduction Company, and in any one or more of the subsidiary companies at the present time?

A. I am vice president in charge of sales of the Air Reduction Company, Inc., Air Reduction Sales Company; I am a director of the Air Reduction Sales Company, and I am a director of the Airco Export Corporation.

Q. Now, throwing your mind back to 1938, what official positions in these companies did you occupy in that year, Mr. Gibson?

A. I was vice president in charge of sales of Air Reduction, Inc., and of Air Reduction Sales Company, in 1938.

Q. In the year 1938, did you have charge of sales generally for the Airco organization?

A. That is correct, sir.

Q. And did you have some individuals directly responsible to you, that is, assistants in that matter, in 1938?

A. Yes, I had three assistants.

Q. Who were they?

A. H. F. Henriques, assistant general sales manager, and J. J. Lincoln, Jr., assistant general sales manager, and a man by the name of C. M. Bloodgood, as the sales manager.

Q. Now, under your general supervision in the year 1938, how many departments were there?

A. There were five departments reporting directly to me on sales, and 25 district offices, headed up by a district manager. Do you want me to give the departments?

[fol. 129] Q. In other words, the broad sales activity of the Airco organization was broken down into five separate phases of sales activity; is that right?

A. Yes, sir.

Q. Now, will you just enumerate for us these five branches of your sales department?

A. Well, we had a gas sales department, headed up by Mr. Pettigrew, who was manager of gas sales; we had an apparatus sales department headed up by a man by the name of H. W. Reade; we had an advertising department headed up by a man by the name of Van Alstyne; we had an applied engineering department headed by H. L. Rogers; and then we had a railroad sales department which handled sales to all steam railroads throughout the United States, headed up by C. B. Armstrong.

Q. Yes. Now, first, as to the department which appears on the chart as gas sales, under Mr. E. F. Pettigrew; will you just tell us what the sales activities of that branch of sales related to?

A. Well, Pettigrew controlled—formulated the gas sales policy and sales procedures for 25 district offices and handled the sales which are listed under his box in this chart: oxygen, hydrogen, nitrogen, acetylene, argon, neon.

Q. Did the department then have general charge of that branch of the department of sales procedure?

A. That is right.

Q. How was that matter of sales procedure related to the district offices?

A. Well, I don't know that I understand your question.

Q. Well, did the sales procedure employed in the district offices throughout the country originate under Mr. Pettigrew? Was that one of his functions?

A. Yes, that is right, he established the sales procedure which was followed by the district offices, by our sales managers, in selling these gases to industry.

Q. There was also, as appears from the chart, a department known as the applied engineering department, and, as I understand it from the chart, that was under Mr. H. L. Rogers in 1938?

[fol. 130] A. That is correct.

Q. Will you tell us what the functions of that department were, and the Airco companies for which it functioned in 1938?

A. Well, they performed services for Air Reduction, Inc., and all of its agency companies, on handling the technical sales problems which came up from the field, from our customers. In other words, their whole function was related to processes of the uses of our products, of all companies, with all of our customers in the field. In other words, they were really the technical sales department. The applications of our products are technical and it is a very important department, and we do need it.

Q. Will you tell us just a little bit more about the type, concretely, of the service which this department rendered to customers?

A. Well, they had an awful lot to do, the applied engineering department, in actually applying the use of our products to operations that the customers were interested in having performed. For example, I can remember when, in 1938, surely, and before that, when the railroads were using shrink fits in connection with putting locomotive wheels on axles. The old method of doing that was heating the wheel and then putting the wheel on and letting it shrink and we developed a scheme by taking carbon dioxide ice and cooling off alcohol with carbon dioxide ice so that the temperature went down and it would shrink the axle and heat the wheel and you would get a differential of about 600 degrees Fah-

renheit in temperature. They developed that. It was a process that looked as if the railroads would use it in the scraping of ships, cutting of cars, the design of doing all that, the economies of working those kinds of operations out with the customers is a duty and function of the applied engineering department.

Q. And did the applied engineering department function in those capacities which you have indicated to us, for all these Airco companies?

A. That is correct. The first case I cited was a straight case of carbon dioxide ice.

Q. Yes. Now, I notice from the chart that the next branch of the sales department was railroad sales. That was under Mr. C. B. Armstrong, was it not, in 1938?

[fol. 131] A. Yes, sir, that is right, sir.

Q. And Mr. Armstrong reported directly to you?

A. He did.

Q. As did Mr. Pettigrew and Mr. Rogers; is that right?

A. That is correct.

Q. Now, briefly, what did the railroad sales department do?

A. Well, the railroad sales department controlled the sales of all of our products to railroads. The railroad fraternity is a pretty integrated fraternity. The procedure of operating railroads is fairly well standardized, and it seems to be customary and certainly was advisable in our case to have a specialized sales organization to handle sales to railroads, and he was in charge of that department.

Q. And what type of Airco products were sold to railroads in 1938, and at other times?

A. Well, we sold oxygen, acetylene, some hydrogen, some nitrogen, oxy-acetylene equipment, electric welding equipment. The railroads use some carbonic dioxide ice in connection with the operation I have previously described.

Q. Would it be true to say, then, that through the railroad sales department, products made by all of these Airco companies were sold to railroads?

A. I can't think of any that are not sold to them.

Q. Yes. Now we move along to the next department, which I note from the chart is called the apparatus sales department. Was that under Mr. H. W. Reade in 1938?

A. That is right.

Q. And did Mr. Reade report directly to you?

A. He did.

Q. Will you tell us what the scope and function of that department was in 1938?

A. Well, the apparatus sales department, again, controlled the policy, had a lot to do with the pricing of our oxy-acetylene equipment, of our electric welding equipment, and some of our carbon dioxide equipment, in connection with apparatus sales, equipment sales to industry.

Q. The next department, I note from the chart, was the advertising department. Was that under Mr. G. Van Alstyne in the year 1938?

[fol. 132] A. That is right, yes, sir.

Q. And Mr. Van Alstyne reported directly to you?

A. Right.

Q. Now, will you tell us just what the function and scope of that branch of your general sales department were under Mr. Van Alstyne in 1938?

A. Well, the function of that department was to lubricate the activity of our field forces and develop advertising and introduce it, write copy, run exhibitions from the standpoint of demonstrating exhibitions and expositions such as the American Welding Society and controlling those exhibits for Air Reduction and its agency companies.

Q. And what products did this advertising phase of your sales department advertise?

A. All products of Air Reduction Sales, Wilson Welder and Metals, National Carbide, Pure Carbonic.

Q. In other words, the whole field of what we have called Airco products; is that right?

A. Yes, sir.

Q. For the entire Airco organization?

A. That is right.

Q. Now, I show you three dividend notices of the Air Reduction Company. They are annexed to each other, and I ask you if those notices, in the form, I believe, of blotters, were gotten up by Mr. Van Alstyne's advertising department?

A. Yes, these are typical dividend blotters prepared by our advertising department, approved by Air Reduction, Inc., announcing our earnings for a given period, and describing to our stockholders our function as sales companies for the products we sell.

Mr. Wilson: I will offer those three exhibits in evidence.

Mr. Maddox: I object to the exhibits. They have no bear-

ing on any issue in this case. What they sent out, in the way of advertising, to the stockholders, has no evidentiary value as to the functions of these different companies.

The Court: The objection is overruled, and the Exhibit will be received in evidence as Petitioner's Exhibit 25.

(The blotters were marked Petitioner's Exhibit 25 and received in evidence.)

[fol. 133] By Mr. Wilson:

Q. Now Mr. Gibson, I show you this General Catalog No. 21, which is entitled "Airco—Airco Welding & Cutting Apparatus and Supplies—Air Reduction Sales Company." I ask you if that catalog was prepared by the Advertising Department under Mr. Van Alstyne?

Mr. Maddox: At what time?

By Mr. Wilson:

Q. And whether it was in use in 1938?

A. Well, it was copyrighted in 1938; it says so on the fly leaf. Yes; it was made up by our Advertising Department, and it is a general catalog describing, in the contents, all of the products of all of the companies of Air Reduction Company, Inc.

Mr. Wilson: I offer that catalog in evidence.

Mr. Maddox: I have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 26.

(The catalog was marked Petitioner's Exhibit No. 26 and received in evidence.)

Mr. Maddox: I would like to call your Honor's attention to one thing that has existed with all these exhibits, and they have gone in without objection, some of them, and that is this: invariably they start with "Air Reduction Company, Inc.," and that happens in each instance to be a fly leaf that that is attached to the exhibit. I am not admitting that characterization of any of these exhibits. They are going in for their content, that is, what the exhibit is itself.

The Court: Oh, yes.

Mr. Wilson: May I make that abundantly clear? That is just a handy way of referring to the exhibit, and we have no

intention of making that a part of the exhibit in any strict sense at all, Mr. Maddox.

The Court: Very well.

By Mr. Wilson:

Q. Now, Mr. Gibson, I show you what appears to be a technical bulletin. It is labeled "Medium Pressure Oxy-acetylene Installations." I will ask you if that was a technical [fol. 134] bulletin which was prepared by the advertising department under Mr. Van Alstyne and which was in use in 1938?

A. This is a typical bulletin which is prepared by our advertising department, and which relates in this particular case to medium pressure oxy-acetylene installations.

Mr. Wilson: I will offer that bulletin in evidence.

Mr. Maddox: I have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 27.

(The bulletin was marked Petitioner's Exhibit No. 27 and received in evidence.)

By Mr. Wilson:

Q. Mr. Gibson, I show you two other pamphlets, apparently technical in nature. The first is entitled "Airco Acetylene," and the second is entitled "The Airco D. B. No. 10 Radio Graph, a portable, motor-driven, gas-cutting machine." I ask you if both of those pamphlets were prepared by the advertising department under Mr. Van Alstyne and were in use in 1938.

A. Yes, sir, they were.

Mr. Wilson: I will offer those two pamphlets in evidence as one exhibit.

Mr. Maddox: No objection.

The Court: The two pamphlets will be received as Petitioner's Exhibit No. 28.

(The two pamphlets were marked Petitioner's Exhibit No. 28 and received in evidence.)

By Mr. Wilson:

Q. Now, Mr. Gibson, I understood you to say that from time to time Air Reduction participated in various public exhibitions of its products throughout the country.

A. Yes, sir. That is correct.

Q. Was that part of the normal and regular program of the advertising branch of your sales department?

A. That is right, that was one of their functions.

Q. Yes. And at those exhibitions, how was it customary to advertise the products of these companies?

[fol. 135] A. Well, the exhibitions that we paid the most attention to were the ones that allowed us to give live exhibits, in demonstrating our products and process. A lot of times, due to fire regulations, they were not allowed, but in all cases the products of the companies were on display. That is what we paid for in the way of space, that is what we wanted to show.

Q. And is it true to say that, when you mention the products of the companies that you are referring generally to Airco products?

A. That is right.

Q. Now, I show you this pamphlet, which is entitled "Welding and Cutting Show, Practical Demonstration of Gas and Electric Welding," and ask you if that is a pamphlet which relates to a welding and cutting show in which Air Reduction Company participated?

A. What was your question, Mr. Wilson?

Q. Does that pamphlet depict a welding and cutting show in which the Air Reduction Company participated?

A. Yes, there are pictures in here of a show that we participated in, and also other information.

Mr. Maddox. Were you speaking of 1938?

By Mr. Wilson:

Q. What was the date of that show? Was it somewhat prior to 1938? I think it may have been.

A. Well, there is no way of—this was copyrighted in 1935, Mr. Wilson, according to this particular pamphlet.

Q. Well, was that pamphlet used subsequent to 1935 for a number of years, so far as you know?

A. That is right. This is the type of thing that we used when we had a show, or that we passed out at shows, but whether we used this actual one in 1938, I couldn't answer that.

Q. But the fact that the pamphlet was copyrighted, I think you said in 1935, would not necessarily indicate that it was only used in 1935 and not thereafter, would it?

A. No, it wouldn't.

Mr. Wilson. I will offer that pamphlet in evidence.

Mr. Maddox: Now, as the witness stated, this has no connection with the taxable year with which we are concerned, or any issue involved. I object to its introduction.

[fol. 136] The Court. Well, I understood the witness to say that he couldn't positively state whether that was used in the year 1938 or not, but that such pamphlets were used at the shows in which this company participated. I will overrule the objection and will admit that pamphlet as Petitioner's Exhibit 29.

(The pamphlet was marked Petitioner's Exhibit No. 29 and received in evidence.)

By Mr. Wilson:

Q. Mr. Gibson, I show you five photographs in a group. The first of them purports to show the Airco exhibit at the American Mining Congress coal show, Cincinnati, Ohio, in 1936. The next an exhibition of Pennsylvania State Association of National Association of Power Engineers, Reading, Pennsylvania, in 1936. The next an Air Reduction exhibit at the National Metals Exposition held at Cleveland, Ohio, in 1936. The next an Air Reduction exhibit at the New York Power Show held at the Grand Central palace, December, 1936. And the last, a photograph of the Airco exhibit in connection with the manufacturers' exhibits at Milwaukee Purchasing Agents' Exhibition, Milwaukee, Wisconsin.

I ask you if you can identify those as photographs which were prepared under the general direction of your advertising department, of the exhibits used by Air Reduction Company in these various shows, as I have indicated?

A. Those are photographs of exhibits which we gave at those locations at the times that you designated, in which we have all of the products—I think they are all of the products—on display. These photographs were representative exhibitions which Air Reduction and their agency companies have attended for years, to show our products to prospective customers.

Q. When you speak of "our products," are you referring generally to what have been called here "Airco products," the products of the whole group? The whole group of companies?

A. That is right, the whole group.

Q. And are those photographs typical of the general way

in which Airco has advertised its Airco products over the years and in the usual course of its advertising methods as respects public exhibitions

[fol. 137] A. That is correct.

The Court. You may attach those as one exhibit.

Mr. Wilson. Yes, I will offer these five photographs as one exhibit.

Mr. Maddox. No objection.

The Court. They will be received in evidence as Petitioner's Exhibit 30.

(The five photographs were marked Petitioner's Exhibit No. 30 and received in evidence.)

Mr. Wilson. Perhaps your Honor would like to get a visual impression of some of these aspects of our work.

The Court. Yes, thank you.

By Mr. Wilson:

Q. Now, Mr. Gibson, I show you three photographs in one group which all purport to relate to the National Metals Exposition held at Atlantic City in October, 1937. They purport to be three separate views of the Airco exhibit at that exposition. I ask you if you can identify them as such, and as having been prepared by the advertising department under Mr. Van Alstyne.

A. Yes, these are photographs of the exhibit that you referred to, and the design of this exhibit and the construction, supervision and construction of it, was done under the direction of our advertising department.

Q. And is that also, like the ones we just placed in evidence, typical of the general way in which Airco products, generally, for the entire Airco organization, were exhibited at these expositions over the years?

A. With the exception of the degree of elaboration, this is entirely typical.

Q. In other words, this is a rather highly elaborate exhibit?

A. Yes.

Mr. Wilson. I offer these photographs in evidence as one exhibit.

Mr. Maddox. No objection.

The Court. It will be received in evidence as Petitioner's Exhibit No. 31.

(The three photographs were marked Petitioner's Exhibit 31 and were received in evidence).

[fol. 138] By Mr. Wilson:

Q. Mr. Gibson, can you tell us how the expense incurred in these advertising procedures which we have just been inquiring into was handled by Airco and the four subsidiary companies?

Mr. Maddox. You say the expense of the exhibits?
Mr. Wilson. The expense of advertising.
The Witness. The expense of advertising.
Mr. Wilson. Yes.

A. Well, the Air Reduction Sales Company had prepared the budget which was approved by Air Reduction, Inc., and in that budget provision was made for advertising the products of all separate sales agencies. In other words, in that budget provision was made for advertising Pure Carbonic, Wilson Welder, National Carbide, Air Reduction Sales.

Q. And so far as you know, was any charge ordinarily made against any particular subsidiary company for advertising its particular products?

A. No, our advertising department, as covered in that chart, performed that work for all companies without charge.

Q. Now, I notice from the chart here that you also had general supervision over district sales managers in 25 districts in 1938; is the right?

A. That is right.

Q. And those were district offices, as appear from the chart, of the Sales Company, National Carbide, and Wilson Welder; is that right?

A. That is right. May I look at this chart?

Q. Certainly.

A. That is right.

Q. Now, in the general problem of selling, was there a difference in the type of customer that purchased carbon dioxide as against the type of customer who purchased the other gases, such as oxygen and acetylene? Will you tell us about that phase of it?

A. Yes, the products of Air Reduction Sales and the Wilson Company and the Carbide Company were all related pretty much to the iron and steel and metal working industry. Of course, the sale of carbonic gas was somewhat [fol. 139] different in that carbon dioxide was used as the vivifying agent in some of the drinks, and in bottling and in that type of trade. So the two markets were not very closely related, except from the standpoint of distribution.

Q. With reference to Wilson Welder, how did it dispose of its products, generally?

A. Through our district offices.

Q. And was any portion of its products transferred to any other of these subsidiary companies?

A. Yes; Air Reduction district offices took better than 60 percent of the products of the Wilson Company in 1938, I believe, and we distributed those through our district offices. I mean we actually distributed the products; sold them.

Q. What happened to the balance?

A. Well, they had a dealer set-up, as I remember it, the Wilson Company had a dealer set-up and they sold that to those dealers directly.

Q. And that was the situation in 1938 and in other years?

A. That is right.

Mr. Wilson: Your witness, Mr. Maddox.

Cross-examination.

By Mr. Maddox:

Q. Now, Mr. Gibson, your first department there, gas sales, that pertains principally to the products that were sold by Air Reduction Sales Company, does it not? Do you have the chart before you?

A. That is right.

Q. Now, the department, apparatus sales, the fourth one over, that is the selling of the equipment for the use of gas on behalf of the Sales Company?

A. Well, not entirely so. We sold other equipment besides that for the use of gas. We sold electric welding equipment.

Q. But that was for Wilson products, that was sold through Wilson Welder?

A. That is right.

Q. Why were the railroad sales segregated and specialized?

A. Well, for the reason that I stated. The whole railroad situation is a fraternity, and you really need a specialized sales organization to handle the railroads.

[fol. 140] Q. That is the only reason?

A. That is the only reason.

Q. What was the principal product you sold them?

A. We sold all our gases, and we sold electric welding equipment, we sold oxy-acetylene equipment, we sold some carbon dioxide.

Q. To what extent did you sell electric welding equipment?

A. To what extent?

Q. Yes.

A. Well, I don't know that I understand your question. Do you want it in volume?

Q. To what extent? What do these sales amount to? Were they substantial or were they just——

A. Oh, they were reasonably substantial. The railroads use a lot of electric welding equipment.

Q. Isn't it necessary to have an electric current supply available for the use of that equipment?

A. Not always. We have Diesel equipment that doesn't require electrical power but electrical power is usually available.

Q. Is that the type they bought, that generated its own current?

A. No, they usually bought the arc welding sets where they could supply their current.

Q. Now, was railroad sales segregated through the Sales Company, and the Wilson Welder Company?

A. No, sir; the railroad sales department handles the sales for those companies to railroads.

Q. For the Sales Company and the Wilson Welder Company?

A. Yes, sir.

Q. I notice Petitioner's Exhibit 26, designated as General Catalog No. 21. Were there other general catalogs besides this one that were in use in 1938?

A. No; the catalog is an expensive piece of printed matter to get out and we would try to keep our catalogs up to date but I don't think there were any other general catalogs.

Q. This was the only one in 1938?

A. As far as I can remember, sir.

Q. Is this the catalog that was distributed to the buying public, the public that was interested in the products?

[fol. 141] A. Yes, sir.

Q. Now, the blotters, the dividend notices, they went to your stockholders, did they not?

A. That is right.

Q. And no one else?

A. Well, now, let me think. That was the principal distribution.

Q. That was a notice to the stockholders of the dividends, was it not?

A. That is right.

Q. And those blotters were not distributed to the buying public?

A. No, sir; I don't think they were.

Q. Now, this bulletin, Supplement No. 17, as it is designated, do you recall that?

A. If you hold it up, I may recognize it.

(Counsel does as the witness requested.)

A. Yes; I do.

By Mr. Maddox:

Q. To whom was that distributed?

A. That is an internal publication which was distributed for our technical sales force, our sales people in the districts, and our people in the New York office, and all of our plants. It is an internal bulletin.

Q. This went to the personnel?

A. That is right.

Q. And did not go to the public?

A. That is right.

Q. And this particular bulletin deals with what, do you recall?

A. Well, I have forgotten the title of it, sir, but I thought that was low pressure generator installations.

Q. "Medium pressure oxy-acetylene installations."

A. Yes.

Q. Is that the subject matter and that is what it deals with?

A. That is right.

Q. And that was to inform the sales force of the products and their use?

[fol. 142] A. That is right, on generator installations, for carbide and acetylene distributing systems for customers' plants.

Q. Now, Petitioner's Exhibit 28, designated "Airco D. B. No. 10, Radio Graph," do you recall that?

A. Yes, sir.

Q. To whom was that distributed?

A. That was distributed to the trade. Anybody that we thought, in the sales department, would be interested in using that machine, we would send it out to them.

Q. That was sent to the sales——

A. No, sir; that was mailed to the general buying public, who used those machines.

Q. Was it mailed from New York?

A. No, sir, we usually mail those through our district offices.

Q. You supplied a quantity to each sales office?

A. Yes.

Q. And then they determined to whom they would mail them and it was for distribution to the public?

A. Yes, sir.

Q. Is that also true of this part of the exhibit that I didn't show you before, the same exhibit?

A. You mean if it is distributed to the public?

Q. Yes.

A. Yes, it was.

Q. In the same manner?

A. In the same manner.

Q. Does the "D. B." of "Airco D. B." have any significance?

A. Well, many years ago we had a product known as "D. B. Torch," and we wanted to keep the name, so for many years we named it "Airco" and then attached to it "D. B." to show the lineage in the product.

Q. Was that understood for many years?

A. Well, it was then. Later we discontinued it.

Q. It was, however, in 1938?

A. Yes, sir.

Q. Now, we come to Petitioner's Exhibit 29, which is designated "Welding and Cutting Show," do you recall that?

A. Yes, sir.

Q. Can you explain a little more fully what is meant by a "Welding and Cutting Show?"

[fol. 143] A. Well, it was an exhibition that we gave. It was just exactly that. A welding and cutting show. We demonstrated the use of our products and issued those publications to those in attendance.

Q. Where was the show held?

A. Well, may I look at that, please?

Q. Yes. Did you do that periodically?

A. Yes, we held it periodically. This describes the welding and cutting show that we had throughout the United States, that we conducted. And during those shows, these are photographs of the actual attendance at various shows, and during those shows we actually distributed to the audience pamphlets describing our products, because we felt that they were interested in coming to the show and this pamphlet described the products demonstrated at the show.

Q. And this is one of the pamphlets?

A. That is right, sir.

Q. And those were strictly Airco products?

A. Yes, those were all Airco products.

Q. It wasn't an exposition where other competitors were competing?

A. No, in that particular case other competitors were not competing.

Q. Now, I show you Exhibit 31, which is composed of three photographs. Are they all of the same exhibit? Different views of the same exhibit?

A. I will have to look at them: Well, certainly these first two photographs are of the same, and I would say the third one is, too, yes. It is part of the wing. It doesn't show the center pillar but it is part of the same show. This is the center of the thing there and if you will notice, these balconies, that is the wing that came up against the balconies.

Mr. Wilson: Mr. Gibson, his Honor would like to hear all this.

The Witness: Excuse me.

The Court: That is all right. I think I understand.

The Witness: I was just describing the photograph.

The Court: That is all right.

[fol. 144] By Mr. Maddox:

Q. Now, I refer you to the third of these photographs and ask you what is blanked out of this name. It shows "The"

and then "Manufacturing Company." Was that part of your exhibit?

A. I can't tell, sir, I can't read that.

Q. Well, do you recall the exhibit?

A. Yes, I recall the exhibit.

Q. Well, why was this name blanked out?

A. I don't think it is blanked out. There is something in front of it.

Q. Well, there is something in front of it, surely. You don't recall the exhibit, aside from the photograph?

A. No, I can't read that printing there.

Q. Do these exhibits, Petitioner's Exhibits 25, 30, and 31, which are principally photographs or prints from photographs, represent all of that type of advertising matter that the company has made use of in 1938?

A. I can't answer that question. I don't know. I don't think so.

Q. Did you make a selection of these particular ones from a group?

A. No, sir, I didn't.

Q. Who did, do you know?

A. I don't know.

Q. You had nothing to do with the selection?

A. No, sir.

Q. Was there other matter of that nature?

A. Well, I will answer that by saying, sir, I think so.

Q. As a matter of fact, there was considerable of it, was there not?

A. No, I won't say that at all. These shows are pretty expensive and we didn't go to these exhibitions too often. There were only one or two a year, maximum. So I would say not. From the standpoint of these actual shows, I would say these represented our demonstrations in 1938. I thought you were talking about printed matters.

Q. But you didn't make the selection of these particular photographs yourself?

[fol. 145] A. No, sir; I did not.

Q. The matter of exhibitions was under your control?

A. Yes, sir.

Q. Is that also true of the catalog here? Did you make the selection of that?

A. No, sir; that is our only catalog.

Q. That is the only one, there was no question of selection there?

A. No, sir.

Q. How about the pamphlets and bulletins? Did you make the selection of those?

A. No, sir; I did not.

Q. Were there other pamphlets than these?

A. I assume so, sir. I mean the—from the general production of our advertising department, I would think so.

Q. Now, with reference to the last block on the chart, in your direct examination, you said that Wilson products were distributed through Air Reduction district offices. Is that what I understood you to say?

A. That is right, sir.

Q. Well, now, those are the 25 district sales offices indicated there? Under the block?

A. That is right.

Q. With reference to the information in these blocks, for instance, where that says "Sales," that means the Air Reduction Sales Company?

A. I would think so.

Q. And "Wilson Products," that means Wilson Welder and Metals Company?

A. Where it says "Wilson" it would mean "Wilson Welder and Metals Company," yes.

Q. Now, did you mean, when you said that Wilson products were distributed through the 25 district offices, did you mean that they were distributed by Sales Company or did it just happen to be that the 25 sales offices were joint offices through which the Sales Company, the Wilson Welder Company, and the National Carbide operated their sales force?

A. No, I meant that our 25 district offices handled the products of Air Reduction Sales and Wilson and stocked [fol. 146] these items in those district offices, that gave a local supply and we actually sold those products.

Q. In other words, the sales force of the Sales Company, Air Reduction Sales Company, and Wilson Welder, and National Carbide were all located at the same point, same accommodations; is that right?

A. No, but these products were handled through those offices.

* * * * * * *

Q. I think, Mr. Witness, before lunch, we were talking about the 25 district sales offices. Can you explain those a

little more fully and just how they function, and who they function for?

A. Well, a district office is composed of a district sales manager and an organization of a varying number of field men, sales representatives, with applied engineering and technical assistants, and they were held responsible for the sales of all of our products within a given area. That area was usually described by the location of its plant and the area in that vicinity.

Q. Were there sub-offices under the district offices?

A. Only in one or two cases there were, sir.

Q. But there are a number of men scattered throughout the territory of each district office?

A. That is right, sir.

Q. And did those men go out into the field, I mean the field men, the men who actually did the selling, did they go out in the field and sell products of the Sales Company, National Carbide Company, and Wilson Welder indiscriminately, and without regard to their position? I mean were they free to go out and solicit business for any of those products?

A. Absolutely.

Q. There was no assignment of any salesmen to any product?

A. No, sir.

Q. And that is true throughout the whole organization?

A. Yes, sir.

Q. Did the carbide salesmen sell oxygen?

A. What do you mean, the "carbide salesmen"?

Q. How did you handle your organization?

[fol. 147] A. We will say we had five salesmen in a given territory, two technical men. Those fellows went out and sold the products that you mentioned to any customers, irrespective of who they were. They would sell carbide, electrodes, gases, acetylene, acetylene welding equipment, and electric welding equipment.

Q. How about the carbon dioxide, did they sell any of that?

A. In some cases they did, but, generally speaking, sir, in connection with carbon dioxide, it was a different sales setup.

Q. I see. Explain a little more fully how the sales were operated. You say there were two technical men. Were there any others?

A. I didn't say there were two. I said there were a few technical men in connection with each of our district offices.

Q. A few. What do you mean by "a few"?

A. Well, a sales organization in the district consisted of a district manager, assistant district manager, and a field organization, and that field organization was made up of salesmen and representatives of our technical sales staff.

Q. I see.

A. And that was the organization. That was the field organization.

Q. And you say you had a few technical men selling? What were the other salesmen, then?

A. Well, those men were the members of the applied engineering department, as I described it.

Q. Were there any others besides those in the field?

A. No, sir.

Q. How long have you been with the company?

A. 26 years.

Q. Did you start with the organization, then?

A. Sir?

Q. Did you start when it was organized?

A. No, sir.

Q. What company did you start with?

A. Well, I think you might say that I was with the General Electric Company for a very short time, between my freshman and sophomore years at college. I have been with no other company.

. . . . . .

[fol. 148] Whereupon W. C. KEELEY, a witness called on behalf of the Petitioners, was first duly sworn, and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Mr. Keeley, what positions do you hold with Air Reduction Company and any of the subsidiary companies at the present time?

A. I am vice president of Air Reduction, Inc., vice president of Air Reduction Sales, director of National Carbide, and a director of Wilson Welder and Metals.

Q. And how long, in all, approximately, have you been connected with Air Reduction Company and these other companies?

A. 25 years next Tuesday; that is from 1920.

Q. In 1938 what positions did you hold with Air Reduction Company and with the subsidiaries?

A. I was vice president of Air Reduction, Inc., vice president of Air Reduction Sales, director of National Carbide Corporation, and director of Wilson Welder and Metals.

Q. As vice president of Air Reduction Company, did you have charge, in 1938, and in other years, of the branch of its operations known as the financial branch?

A. Yes, sir.

Q. And that branch is indicated on this organizational and functional chart which has been marked Petitioner's Exhibit 22, is it not?

A. Yes, sir.

Q. In connection with the financial branch of operations, what company or companies did you and your department serve?

A. We served the Air Reduction Company, Inc., and all four agency companies.

Q. What general divisions were there in the financial department which you supervised in 1938 and in other years?

A. Well, there were nine divisions. They were, payroll section, purchasing department, cash section, special assignments and field office audits, office service, credit and collections, pension policies, field office management, cylinder records

[fol. 149] Q. And as appears from the chart here, did the functions of your financial branch include supervision of the treasurer's office and also the general accounting office?

A. That is correct.

Q. Now, is it correct, as appears from the chart here, that the treasurer, R. W. Ryder, reported and was directly responsible to you?

A. Yes, sir.

Q. And what positions did Mr. Ryder hold in 1938?

A. He was treasurer of the Air Reduction Company, Inc., and the four agency companies.

Q. Treasurer of each of the companies?

A. That is correct.

Q. And did Mr. L. A. Hull, as appears from the chart, report directly to you?

A. Mr. Hull was assistant vice president of the company and handled the—of the Air Reduction, Inc., Air Reduction Sales, and handled the subsidiaries National Carbide and Wilson Welder and Metals.

Q. Now, I should like briefly to run through these various sections of the treasury department. I believe you said there were nine of them. First, as to the section which appears on the chart as the payroll section: was that under the general charge and supervision of Mr. E. R. Holmes in 1938?

A. Mr. E. R. Holmes was assistant treasurer of all the companies and handled payrolls for all the companies at that time.

Q. When you say "all the companies," do you mean Air Reduction Company, Pure Carbonic, National Carbide, Wilson Welder and the Sales Company?

A. Yes, sir.

Q. And next, the purchasing section: was that under the charge of Mr. Daggett in 1938?

A. Mr. Daggett was purchasing agent for Air Reduction, Inc., and for the four agency companies, and had complete charge of all purchases for all of the companies in excess of $50, which was authorized for emergency purchase orders in the field.

Q. Can you tell us a little bit about the purchasing procedure of the company as it was connected with that department during the year 1938, and as it applied generally in other years?

[fol. 150] A. Well, the agency company, or field office, or department head, whoever needed a requirement of material, or the purchase of any particular sort of material, placed a requisition which went to the general stores department, to see whether the general stores department had that particular item in stock. If it did not have that item in stock, this requisition was forwarded to the purchasing department under Mr. Daggett, and he put out inquiries to the various vendors supplying that type of material and ultimately made the purchase for the requisitioning branch or agency.

Q. And were purchases carried on generally according to the procedure which you have outlined for each of these subsidiary companies?

A. Yes; it was carried out as a unit for all of these companies. The purchasing might be done in several different ways. For instance, Air Reduction Sales Company might have a contract with a vendor for material carrying a discount. In turn, one of the other subsidiaries might need that material and the purchase order was then issued on the vendor to supply the other subsidiary through the original contract. There was no differentiation made in purchasing between companies. It depended on the convenience of the purchasing department.

Q. Can you give us an illustration or two of that type of purchase which you have just finished describing?

A. Well, I can think of one or two. For instance, Air Reduction Sales has had a contract for many years for the purchase of caustic soda. Pure Carbonic also uses caustic soda, and purchase orders were issued and deliveries were made to Pure Carbonic under the Air Reduction Sales contract.

Other examples of where that type of buying was done would be stationery. We have standardized the forms as much as possible between the companies. They are all more or less Airco forms, and they are purchased usually in large blocks and then utilized by the different requisitioning and purchasing units.

Q. Now, I should like to show you photostatic copies of certain documents. I beg your pardon. They are printed forms, in this case. I will ask you if they are the forms concerned with the purchasing procedure which were in use [fol. 151] in 1938 and at other times by the Airco organization purchasing department?

These forms are as follows: the first one is described as a form for request for offers. The next one is a form for purchase and general stores requisition. The next one, a form for purchase order, and supplement to purchase order.

I think that is the entire group and I will ask you to identify for us, if you can, whether those were the regular purchasing forms that you used.

A. Those are the general Airco forms used for all companies.

Mr. Wilson: I will offer these papers in evidence as one exhibit.

Mr. Maddox: No objection.

The Court: They will be received in evidence as Petitioner's Exhibit No. 32.

(The forms were marked Petitioner's Exhibit No. 32, and received in evidence.)

By Mr. Wilson:

Q. Now, Mr. Keeley, I notice on the chart, Petitioner's Exhibit 22, that the next section in the treasury department is described as the "cash section." By whom was that particular section headed directly in 1938?

A. It was headed by Mr. F. J. McCulloch. He was assistant treasurer for all companies, he handled the cash for Air Reduction, Inc., and all the agency companies. The cash was accumulated, of course, in the districts and transmitted to their own local accounts, of which there are about 150 current accounts plus the petty cash account regularly. Mr. McCulloch was empowered to draw on these accounts and would utilize the cash, you might say, indiscriminately between companies, because he was able to draw on any bank account to make up a shortage in a requirement of another agency or of the parent company. For instance, if we had a tax payment or a dividend to make in Air Reduction, Inc., cash balances were withdrawn wherever they were available over operating requirements in the district bank accounts.

Q. Did each of these subsidiary companies have a separate bank account?

[fol. 152] A. Yes, each company had a good many separate bank accounts. These bank accounts usually were at plant locations or district office locations, and were usually started at the request of the district management, who had a need of such account. That recommendation was made to New York office, and the matter was then taken up with the chairman of Air Reduction, Inc., and if he approved generally the depository, either for convenience or for some other purpose required in the business, this was so approved and then the Board of Directors of the individual agency company formalized this by action and resolution which was then sent forward to the individual bank authorizing the officers' signatures.

Q. I think you did illustrate for us how these funds were drawn upon generally, for the general Airco organiza-

tion purposes. Could you illustrate that any further for us?

A. Well, if National Carbide, for example, wanted cash for plant expansion, which they have had to have recently, that money would be placed in the National Carbide accounts to be withdrawn for that purpose, and the cash would be accumulated from whichever bank had an excess over their operating requirements.

Q. When you say "whichever bank had an excess over operating requirements," am I correct in understanding you to mean whichever bank account of a particular subsidiary had an excess over its own operating requirements? Is that right, or am I in error?

A. No, it would be any bank account of any subsidiary or of the parent company.

Q. Which had the excess?

A. That is right.

Q. Mr. Keeley, I show you this schedule which is headed "Air Reduction Company, Officers authorized to sign checks on bank accounts," and I will ask you if you can identify that for us as a correct presentation of the officers of Air Reduction Company, and the four subsidiary companies who were authorized to sign checks on the respective bank accounts in the year 1938.

A. Yes, that is the list.

[fol. 153] Mr. Wilson: I will offer that schedule in evidence.

Mr. Maddox: If your Honor please, the authority for officers signing checks can be found in the minutes, and I understand those minutes are here and have been marked for identification. Now, apparently this schedule is made up from those minutes—I assume—and should conform with that.

Mr. Wilson: That is correct.

Mr. Maddox: If there is any variance between this exhibit and the minutes, this exhibit should be cast aside. I object to this going in because it is already here in these exhibits, if they are going to be offered.

The Court: Well, I understood the witness to say that that list he has there is the list of officers who had authority to sign checks.

The Witness: Yes, sir.

Mr. Maddox: But it is a secondary exhibit taken from these minutes.

The Court: Well, I assume the minutes are going to be offered at a later date, so I will overrule the objection and admit it as Petitioner's Exhibit 33.

(The schedule was marked Petitioner's Exhibit 33 and received in evidence.)

Mr. Wilson: Apropos of Mr. Maddox's last comment, I should now like to offer in evidence the minutes of the subsidiary companies, which yesterday were marked for identification. They are respectively Petitioner's Exhibits 18 for identification, 19, 20, and 21, all for identification. It was understood yesterday that Mr. Maddox could have these minutes to check, and he did have them, I believe, over night. I should like now to offer them in evidence, and they will provide a convenient method for Mr. Maddox to check the list which we have just put in evidence.

The Court: Very well. Do you have any objection, Mr. Maddox?

Mr. Maddox: No objection.

The Court: The four exhibits which have just been described and which have heretofore been marked for identification will now be received in evidence as Petitioners' Exhibits 18 through 21.

[fol. 154] (The minutes heretofore marked for identification Petitioner's Exhibits 18, 19, 20, and 21 were received in evidence.)

By Mr. Wilson:

Q. Now, referring to Petitioner's Exhibit 33, which has just been received in evidence, Mr. Keeley, it appears from that exhibit, does it not, that Mr. R. W. Ryder was treasurer of Air Reduction Company and of each of the four subsidiary companies?

A. That is right.

Q. It also appears that Mr. E. R. Holmes and Mr. F. J. McCulloch and Mr. F. B. Adams, Jr., were all officers of each of those companies I have mentioned; is that right?

A. They were authorized to sign checks and drafts on funds as officers.

Q. Yes. Now, Mr. Keeley, will you tell us how working capital was provided for each of the subsidiary companies?

A. Well, originally working capital was advanced by Air Reduction Company, Inc., to each one of the subsidiaries. As time went on, they built up additional working capital through cumulative profits which were not turned over to Air Reduction Company, Inc. So that the working capital provided came about in two ways with the subsidiary companies.

Q. As the subsidiary operated, in the course of the year, where did the proceeds of the sales of its particular products go?

A. The proceeds of the sales of each subsidiary company ultimately went to its own profit and loss account, and in accordance with the contract ultimately were transferred to Air Reduction Company, Inc., less the amount of its service fee, which were held.

Q. And when you refer to the service fee, what specifically do you have in mind?

A. I am speaking about the 6 percent on capital which they were entitled to get under the contract.

Q. Under what contract?

A. The agency contracts.

Q. Which have already been put in evidence here?

A. Yes.

Q. With respect to Airco and each of the subsidiary companies?

[fol. 155] A. Right.

Q. Now, suppose the proceeds of operation, by any one subsidiary company had accumulated in its bank account in excess of its own operating requirements. Will you tell us how a situation like that was handled in 1938 and in other years?

A. You are speaking about book profits, on the subsidiary books?

Q. Yes.

A. Book profits were cleared into an inter-company account and became, in the case of a profit of the subsidiary, accounts payable on the books of the subsidiary and accounts receivable on the books of the parent company.

Q. Accounts payable on the books of the subsidiary to whom?

A. Accounts payable to Air Reduction Company, Inc.'s books——

A. From the individual subsidiary involved.

Q. Was there occasion for transfer of working capital from one agency company or subsidiary company to another?

A. I would say that it was continuously being exchanged.

Q. How would that be handled?

A. That would be handled through the inter-company accounts and would be just as I described it in regard to excess. For instance, if there were capital assets transferred from one subsidiary to another, machinery or equipment or something of that kind, it would be transferred in the book cost to the new company, and would become an accounts receivable on the books of the company giving up the equipment and an accounts payable on the receiving company, and this would be cleared through the inter-company accounts.

Q. Did the district officers, the officers in the various district sales offices, make periodic reports to the treasurer?

A. The district office made daily reports of cash received, petty cash paid out, and bank deposits, and from this was made up the combined daily cash report for Air Reduction Company, Inc., and twice each month this consolidated report, which represented the over-all cash of the organization, was submitted to the Board of Directors of Air Reduction Company, Inc.

[fol. 156] Q. And that general field of operation which you have been describing came generally within what is designated here as the cash section under Mr. McCulloch; is that right?

A. That is correct.

Q. Now we pass on to the next section, which is designated on the chart as "Special Assignments, Field Office Audits." Was that section of the treasury department under the immediate supervision of Mr. Bowman in 1938?

A. Yes, Mr. Bowman was assistant treasurer of Air Reduction Company, Inc., and of all the agency companies, and his particular work was in auditing the accounts receivable, petty cash and stores, of the field office and district office account.

Q. Yes. Now we move over to the next section of the treasury department, which is designated on the chart "New York Office Service." Who was in charge of that section?

A. Mr. Ryder, as treasurer, handled this matter himself

through a staff of assistants. They had generally charge of the New York office, which had grown considerably. They had charge of office layouts, and rentals of the area, and allocation of area, to individuals, to departments, porter service, messenger service, telephone service, and so on.

Q. And did that New York office service section of the treasury department function for Airco and the four subsidiary companies?

A. For all companies, yes.

Q. The next section which I see on the chart here is the credit and collection section. Was that immediately supervised in 1938 by Mr. Winters?

A. Mr. Winters was credit manager for the parent company and all subsidiaries. He had complete responsibility for authorization of credit in the district offices and in the New York office. He delegated this authority through his credit clerks in the field, who reported to him twice each month as to open balances of accounts, and once each month showing the delinquent balances for all accounts of about 60,000 customers.

Q. And did that credit and collection section function for Airco and the four subsidiaries?

A. It functioned for all of them.

Q. And that was true in 1938?

[fol. 157] A. Yes.

Q. And in other years?

A. Yes.

Q. And the testimony which you are giving is true as of 1938; is that correct?

A. That is correct.

Q. As well as in other years?

A. Yes, sir. It is true today.

Q. Did Mr. Winters submit any reports in connection with that credit and collection function? If so, to whom and what was their nature?

A. He combined the reports from the district offices showing delinquency, amount of collections, write-offs, and so on, and reported this once each month to the Board of Directors of Air Reduction Company, Inc.

Q. The next section of the treasury department which is designated on the chart is described as "Special Assignments, Pension Policy." Was that section under the immediate supervision of Mr. F. B. Adams, Jr., in 1938?

A. Mr. F. B. Adams, Jr., was another assistant treasurer of Air Reduction Company, Inc., and all agency companies and was responsible for the administration of the pension plan, which we had adopted in 1935. Are you interested in the pension plan?

Q. Yes, you might just describe for us in your own way what that pension plan arrangement was and to what it applied.

A. Well, the pension plan was divided into two parts, one for past service, before May 1, 1935, and the past service was given to all employees of Air Reduction Company, Inc., and of the agency companies who had had one year of service prior to that date. That was accomplished by funds being placed by Air Reduction, Inc., in the Bankers Trust of New York on an actuarial basis to meet these pension requirements.

The second part of the pension plan was for future service, which was a contributory plan whereby the company paid about 60 percent of the total amount and the employee paid 40 per cent, each year, from that time forward. This was done with the Aetna Life, by Air Reduction, Inc., for its own employees and for the employees of all agency companies.

[fol. 158] Q. I should now like to show you just a few exhibits in connection with this retirement income plan.

The first is a pamphlet entitled "Retirement Income Plan for Employees of Air Reduction Company, Inc., and wholly-owned Subsidiaries."

The next is a photostatic copy of a premium statement, or what purports to be a premium statement of Aetna Life Insurance Company, dated May 1, 1938, directed to Air Reduction Company, Inc., and wholly-owned subsidiaries.

The next exhibit in this group is a photostatic copy of what purports to be a check of Air Reduction Company, Inc., payable to the Aetna Life Insurance Company, and dated—the perforation shows it was paid May 21, 1938.

The next is a check of Air Reduction Company, or a photostatic copy of a check, payable to the Bankers Trust Company. That is the last exhibit in the group.

I will ask you if you can identify those exhibits as photostat. nd in the case of the income retirement plan, an authentic pamphlet of the company describing the plan and used in connection with that plan in 1938?

A. Yes, sir.

Mr. Wilson: I will offer that group of exhibits as one exhibit.

Mr. Maddox: No objection.

The Court: They will be received as Petitioner's Exhibit 34.

(The pamphlet, copy of premium statement, copy of check payable to Aetna Life Insurance Company, and copy of check payable to Bankers Trust Company were marked Petitioner's Exhibit 34 and received in evidence.)

By Mr. Wilson:

Q. Now, the next section of the treasury department which I note on the chart, Mr. Keeley, is designated as "Section of Field Office Manager." Who was in charge of that section in 1938?

A. Mr. W. A. Bower was field office manager. He operated the field offices for Air Reduction Sales and Pure Carbonic, and these were the only two companies which had this type of operation, and handled the accounts receivable in the field offices.

[fol. 159] Q. Now, will you tell us a little bit more fully what the nature of this field office management involved?

A. Well, field office management had charge of the—perhaps I had better start again. The chief clerk in each district and field office reported directly to his district manager for discipline and personnel. He reported directly to New York to the field office management section for methods and procedure. The field office management section wrote and continued to write procedures for field office, for standardization of methods and procedures, and also supervised and administered the handling of personnel under the chief clerk.

Q. And under the supervision of the field office management section, was there any sort of standard manual prepared?

A. Standard manuals were prepared and were continuously brought up to date by this section.

Q. The next section that I see under the treasury department is that designated "Cylinder Records Section." Who had immediate charge of that section throughout 1938, Mr. Keeley?

A. Mr. Donald Allen was in charge of the Cylinder Records Section, which was the control section for the

handling of all cylinders for the two companies using cylinders, namely, Air Reduction Sales and Pure Carbonic.

Q. As to this matter of cylinders, can you give us some indication of the extent to which Air Reduction Company, Inc., furnished cylinders in 1938 to the Sales Company and to Pure Carbonic?

A. Yes. Air Reduction Company, Inc., had approximately 850,000 cylinders in service at that time, of which about 600,000 were in service for Air Reduction Sales, and about 250,000 for Pure Carbonic.

Q. Moving over further to the right on the chart, I note the "General Accounting Department." Who had charge of general accounting under you throughout the year 1938?

A. Mr. J. Bonapart was general auditor in the New York Office, handling the control accounts, the general books of Air Reduction Company, Inc., and all four agency companies. He was responsible for the operation of the accounting department. These companies all had separate [fol. 160] ledgers, and books of control at that time, and the various members of the accounting department worked on these books but were not assigned to any particular unit.

Q. Were separate books kept for each subsidiary company?

A. Yes, sir, they were.

Q. And was that matter under your general supervision?

A. Yes, sir.

Q. And in the immediate charge of Mr. Bonapart?

A. Yes.

Q. So far as you know, and to the best of your knowledge and belief, were those books for each separate subsidiary company kept accurately and completely throughout 1938?

A. Absolutely.

Q. Pardon me?

A. Yes, absolutely.

Q. Were these some what we might call subsidiary records kept with respect to the operations of these subsidiary companies?

A. I don't know that I understand what you mean.

Q. I am referring to records in the district or field offices.

A. Yes, the accounts receivable, as I said before, and petty cash records and stores records were kept in the district and field offices. Plant accounts were kept in the individual plant operations. But all of these came together in the general accounting department in New York.

Q. Now, as each subsidiary operated during the course of the year, it accumulated, did it not, profit or loss?

A. That is right.

Q. How was that matter handled in the general Airco setup?

A. Well, each subsidiary had its own set of general books which were cleared to its own general profit and loss account. In the case of a profit to the subsidiary, this was cleared periodically through an inter-company account to Air Reduction Company, Inc. In the case of a profit, that would become an accounts payable on the books of the agency company and an accounts receivable on the books of the parent company.

If it were a loss in operation, it would be just the opposite.

[fol. 161] Q. Well, were the profits and losses of each subsidiary company thus included in computing the profit and loss to Air Reduction Company, Inc.?

A. That was the profit or loss of Air Reduction Company, Inc.

Q. Have you told us how the initial working capital of these subsidiary companies was furnished?

A. I think we did, but I will be glad to repeat it.

Q. Would you just tell us that again, please?

A. Air Reduction Company, Inc., originally furnished the capital for each of the operating or agency companies and as the years went along, they built up additional funds of their own, which were utilized for general corporate purposes, so that the working capital of the subsidiary was obtained in two ways: one, by its own operation, and, two, by the original advance of the parent company.

Q. Yes. Now, under the accounting practice and the operations of these companies, to whom did the funds in excess of that 6 percent annual compensation due under the operating contracts belong and go?

Mr. Maddox: I object on the grounds that that calls for a legal conclusion.

Mr. Wilson: I am asking that on the basis of the treatment which was accorded that by the company in their practical operations.

The Court: Yes. Reframe the question so as to let him detail how it was treated.

Mr. Wilson: Yes, your Honor.

By Mr. Wilson:

Q. Will you just tell us how funds resulting from the operation of each of these agency companies, in excess of the 6 percent annual compensation on the capital stock, were treated?

A. Well——

Mr. Maddox: Were treated where?

Mr. Wilson: By the companies.

Mr. Maddox: On the records or otherwise? I object because the records are the best evidence of how they were treated.

[fol. 162] The Court: Are you going to offer any evidence in that respect? It seems to me that objection would be good, unless you offer something illustrating how it was done.

Mr. Wilson: We will have the books and records here and we can put in the actual records of all these companies if it appears necessary. As a matter of fact, I should say at this point I don't understand that there is any dispute really about how these records of the separate companies, that is the subsidiary companies, were kept. It seems to me that in its treatment of the adjustments, the Government has conceded that those records of the subsidiaries were kept separately and accurately and completely, and I think that is entirely apparent from the fact that when the Government threw back the income from Aireo to the subsidiaries, it accepted the accounting results as reflected in their separate books. But we will have those books here, and if there is any issue at all upon the fact that they were separately and accurately and fully and completely kept, we will regret it, but we will be willing to put all the books in.

The Court: Well, we don't want the records in if it would serve no good purpose. It is my understanding, of course, that the Commissioner has not raised any question here, as I understand it, respecting the practice of these four subsidiaries to turn in all of their profits to the parent company, but he has questioned the legality of that so far as taxation is concerned and has thrown back the income into each of these subsidiaries and has allocated to each one a reasonable part of the expenses.

Now this question, as I understand it, is asked for him to detail, in a general way, how the profits of the years operation were treated by the companies. I think I will

overrule the objection on that, in view of the state of the record and the determination about the deficiencies.

By Mr. Wilson:

Q. Now, will you tell us how that matter was treated?

Mr. Maddox: May I have an exception to the ruling?

The Court: Yes, you may. One more question, first. I don't understand, so far as we have proceeded, that there is any question here as to the amount of the income. If our [fol. 163] court should uphold the petitioners' contention, why, then, the parent corporation has already rendered that income in a proper way and there would be no deficiency.

On the other hand, if we should sustain the theory of the Commissioner, that the separate identity of each of these corporations should be recognized for tax purposes, and the theory of the agencies should be disregarded, then, I don't understand that there is any controversy as to the amount of the income that he has allocated to these respective corporations and the amount of expenses that he has allocated. Is there any issue on that?

Mr. Wilson: May I just have a moment, please? your Honor, I think that is a substantially accurate statement.

The Court: Very well.

Mr. Wilson: And I understand that the Government agrees with that statement, too, as being a substantially accurate statement of the Government's position.

Mr. Maddox: I am content to rest the case on the issues as drawn by the pleadings.

The Court: Well, that is my understanding of them, and I am permitting the witness to answer this general inquiry.

By Mr. Wilson:

Q. Now, have you the question in mind?

A. I think so. The individual agency company has its operating statement prepared monthly, which shows the amount of profit or loss of that agency company. It then transfers that amount, less the agency fee, which it retains on its books, through an inter-company account, to Air Reduction, Inc., and this is done by means of an accounts payable on the books of the agency company if it is a profit, and an accounts receivable on the books of the parent company.

Q. Now, Mr. Keeley, in 1938, and in other years, were there various inter-company purchases? Was that part of the general practice in the Airco organization?

A. Purchases of material?

Q. Purchases of material, and any other purchases.

A. Yes, there were continuous and still are continuous purchases of material. Whichever has been the simplest [fol. 164] way to handle it from the standpoint of paper work. I mean there have been charges paid by agency companies for the parent, such as patent charges and so on. There have been blanket contracts made in the name of Air Reduction, Inc., such as insurance contracts. There have been other material purchases. I think we mentioned them before: such things as stationery bought for one agency company and supplied to other agency companies.

Q. Were there at times transfers of machinery or products, from one agency or subsidiary company to another?

A. Yes, they were more or less continuous.

Q. How were such transfers handled?

A. Well, for example, if National Carbide needed motors, and such motors were available in the hands of Air Reduction Sales Company, Air Reduction Sales Company would sell or transfer these to National Carbide at their then book value.

Q. And were products sometimes transferred from one subsidiary company to another?

A. Products were and are transferred. For instance, as a case in point, if National Carbide Corporation needs oxygen in its daily operation, there is no cash transfer or sale. It is simply transferred as an inter-company entry at cost.

Q. When you say an inter-company entry, will you just explain that a little more fully?

A. I mean through the accounts payable and accounts receivable procedure and cleared through the parent's book on consolidation each month.

Q. And did you say that such transfers were on a cost basis?

A. Substantially always on a cost basis.

Q. Now, were expenses of one subsidiary company sometimes paid by Air Reduction Company, or by another subsidiary company?

A. Yes, in the case of payment for rent, for insurance, in the Lincoln Building. It was paid by one company and that applies and carries the rest for all companies.

Q. Now, I notice on the chart here, rather far over to the right, that Mr. L. A. Hull, assistant vice president of Air Reduction Company, Inc., and Air Reduction Sales Company, is indicated as reporting to you with some phase of [fol. 165] his own functioning. Will you tell us about that phase of your departmental activity?

A. Well, under Mr. Hull there were three main divisions. One reporting to Mr. E. C. Ackerman, reporting to Mr. Hull as vice president of National Carbide Corporation. In going back to the acquisition of carbide, there were certain types of sales, such as mine lamp, house lighting, that type of sales, which did not fit into the standard Airco district sales organization, so those were retained by National Carbide Corporation and handled by Mr. Ackerman. He also handled special types of direct mail advertising to that kind of trade, and handled direct carload shipment.

The general distribution department of Air Reduction Sales, and so on. This particular job of Mr. Ackerman's and his department, handled only direct carload movements.

Q. Now, will you just move along and tell us what Mr. R. F. K. Tothill, who is listed as operating manager of National Carbide Corporation, did? What were his functions?

A. Well, he was responsible for the operation of the two carbide plants, Keokuk, Iowa, and Ivanhoe, Virginia.

Q. And did he report through Mr. Hull to you?

A. That is right.

Q. Now, tell us about Mr. T. B. Hasler, who is shown on the chart as president of Wilson Welder and Metals Company.

A. Well, once again, the same thing applies as before. Certain jobbers that the Wilson Company had prior to our acquiring it continued to do business directly with the Wilson Welder and Metals Company. The balance of the sales were all made through the district office, as Mr. Gibson described before. At that time the Wilson Welder Company had an assembly plant in Union City—assembly of motor generator sets, gas line engine sets, and Diesel engine sets.

Q. Have you already told us the functions of Mr. Ackerman in connection with the distribution of calcium carbide?

A. Yes; carload shipments.

Q. And you have already told us of the functions of Mr. Hasler with reference to the——

A. Jobber sales.

[fol. 166] Q. Jobber sales and so on of Wilson Welder and Metals Company.

A. That is correct.

Q. And Mr. Hasler reported to Mr. Hull, regarding the assembly and sale of Wilson products, and through Mr. Hull to you; is that right?

A. Yes.

Q. Mr. Keeley, how much capital stock, if you recall did each of the subsidiaries have outstanding in 1938, and in other years, and what was the par value of it?

A. May I refer to my notes on that?

Q. Yes, I think you may.

A. In 1938, Air Reduction Company, Inc., had 2,579,855⅓ shares, no funded debt. Air Reduction Sales Company had 125 shares outstanding $100 par value. National Carbide Corporation had 50 shares outstanding at $100 par. Pure Carbonic, Inc., had 50 shares at $100 par. Wilson Welder and Metals had 100 shares with no par value. None of these companies had any funded debt.

Mr. Wilson: That is all.

Cross-examination.

By Mr. Maddox:

Q. Mr. Keeley, you mentioned the payroll department there, the first section, which kept payrolls for all companies.

A. Yes, sir.

Q. Do I understand you to mean that there was a separate payroll for each company?

A. They were drawn on separate bank accounts for each company.

Q. I am talking about making up the payroll, not the bank account or payment of it. I am talking about the payroll itself.

A. Well, I—can I start out at the beginning? It starts out in the field. In your district and field offices you have a direct cash payroll which is paid by the local office.

Q. It that made up for each company?

A. That is made up for each company, and each branch, and each department. It is made up locally at that point.

And that record of that payment comes into the payroll department as substantiation for that charge of the district office.

[fol. 167] The salary payrolls, for all companies, so-called, New York office roll, is made up in this payroll department and sent out to the field from New York, they having made the deductions for pensions, old age benefits, and so forth, in New York.

Q. Well, now, do I correctly understand you to have a separate payroll for Air Reduction Company, Inc., Air Reduction Sales Company, National Carbide, and Wilson Welder?

A. Well, it is lived up to by the breach more than anything else. For instance, a great many people in different agency companies are paid by the check of another agency company. I am afraid that would be a little like Topsy. For instance, in the Air Reduction Sales pay roll in New York, Air Reduction Sales checks are drawn to a great many people actually working for other agency companies. The charges are ultimately made to the proper company.

Q. Isn't there an appropriate charge there on your books when you do that against the other company for which the payment it made?

A. That is correct. That is cleared ultimately to the individual company.

Q. In other words, if Sales Company pays the employee of Carbonic with a Sales Company check, isn't Carbonic charged for that?

A. Yes, sir.

Q. In favor of the Sales Company?

A. That is right.

Q. So while the employee gets the check of the Sales Company, there is the proper appropriate adjustment between the two companies, is there not?

A. That is right.

Q. Doesn't that adjustment run through all these intercompany transactions that you have mentioned? For instance, the purchases of caustic soda by Carbonic on Air Reduction Sales Company's contract. While the purchase is made on their contract, the charge is made against Carbonic, is it not?

A. Oh, yes, against the actual operations of that company.

Q. And that is also true of the stationery item that you mentioned?

A. No, I think not. I think that is a general charge.

[fol. 168] Q. How is that handled, as a general expense?

A. Just as a general expense.

Q. Then, is that allocated against the companies?

A. No.

Q. On the basis of the amount used?

A. I think not.

Q. Do you know if it is allocated as a general over-all expense?

A. Yes.

Q. Did you say yes?

A. Yes.

Q. General over-all expense?

A. Yes.

Q. And it is also true that appropriate records are made between two companies where you take cash out of one company's bank account and transfer it all to the other, isn't that true?

A. Oh, yes. It is all accounted for ultimately.

Q. In other words, there is no question of proper accounting being maintained between the companies, if the cash is transferred over there is a receivable in return, isn't there?

A. That is handled as an open account receivable on the books of the company.

Q. I refer to Petitioner's Exhibit 32, which is supposed to set forth the purchase procedure, and I refer you to something headed "Purchase and General Stores Requisition," and I ask you to indicate to me what goes on the line under which appears "Name of Company."

A. The agency company.

Q. That would be the Air Reduction Sales Company?

A. This is just a general form.

Q. I understand that you have a stores house where you have material or supplies or what not in the stores house, and this is a requisition to draw out of the stores house, is that true?

A. That is right, or to draw on the purchasing department if they don't have it.

Q. That is true. The name of the company would be the subsidiary company?

[fol. 169] A. Whoever required it, yes, Air Reduction Sales or Carbonic; whoever might need the material.

Q. Now, can you tell me what "C and S O Number" means?

A. Charge and shipping number.

Q. And "G S."

A. General stores order.

Q. And "A and P Number"?

A. That I can't remember.

Q. Does this requisition become a part of your accounting records?

A. It becomes a part of the purchase record.

Q. And is there any entry made in your books from that record?

A. Not from the requisition.

Q. Is there any preliminary record made to make appropriate charge to the appropriate company from this record?

A. Well, there is no charge originates until the purchase has been made or until the general store ships.

Q. Well, isn't this a requisition for material? That is all this is, then, just a requisition?

A. That is right.

Q. I see. Then, the record comes later when the shipment is made?

A. Yes.

Q. I refer you to the next paper, which is designated "Purchase Order," and there appear to be a number of sheets bearing the same number, six sheets. That is a series and carbon copies are made?

A. That is right.

Q. Now, I refer you to the words on the face "Shipped to." What goes in there?

A. That would be "Shipped to Air Reduction Sales, Toledo, Ohio," for example.

Q. Or any of the other subsidiary companies?

A. Or any of the other subsidiaries. This is an Airco form used for all of the companies.

Q. Now, I refer you to the item on the face "Charge and bill to" What goes in there?

[fol. 170] A. If the original purchase contract with the vendor was in the name of National Carbide Corporation, we would enter in there "Charge to National Carbide Corporation," and the vendor would bill to that company. If, on the other hand, if was to be billed directly to the com-

pany to which it was shipped, that name would appear in duplicate there.

Q. And if the name here was different then the name where it says "shipped to," then there would be the appropriate charge between the two companies on the inter-company account?

A. That is correct. I think each one of those copies has its own identifying imprint.

Q. Now, there is a page which is headed "Supplement Number (blank) to our Purchasing Order No. (Blank)." The same comments would apply to the words "shipped to and charge and bill to" as you have designated for the purchase order?

A. Yes, sir.

Q. Now, I show you the portion of this exhibit, Petitioner's Exhibit 32, which bears the notation "Purchase Order." The exhibit itself says "Emergency Purchasing Order." It is designated on the face "Emergency." Now, I refer you to the portion which says "For (blank)," and under the line it says "Company to be charged and billed." What would go there on that particular form?

A. That would be the company using it. The issuing office—this might be issued at New York, and it might be for Air Reduction Sales Company at Toledo, or National Carbide at Keokuk or something of that sort.

Q. And that would go in on that particular line?

A. Yes, sir.

Q. Would the designation of the place, for instance Keokuk or Toledo, go on that line under which the words "Company to be charged and billed" appear?

A. Yes, this is an outside form. This is utilized by all companies for purchases up to $50, or for any emergency they may be requiring.

Q. You referred to the daily reports that came in from the field office as to cash. I suppose that was cash collected and deposited in the bank?

[fol. 171] A. That is correct.

Q. Now, did those reports come in from each individual company, like the Sales Company, Air Reduction Sales Company, and the Carbide Company?

A. They came in from every point where deposits were made by a local office, into an account.

Q. And it was a separate report for each company?

A. Separate report for each bank account, and, therefore, for each company, because the bank accounts were separate.

Q. In other words, each office reported, or, rather, sent in several reports, one for each company?

A. Well, not necessarily.

Q. One for each of the subsidiary companies?

A. Well, for instance——

Q. I mean assuming they had cash and deposited cash, would they send in one report or would they send in a report for each company?

A. Well, at the district office of Air Reduction Sales office, they would have one Air Reduction Sales account. Now, no matter what they sold, whether that was products of other subsidiaries, that would be only one deposit.

Q. Well, suppose they made sales on behalf of Air Reduction Sales Company, and also National Carbide, and they collected cash and deposited that cash, would there be one or two reports?

A. One.

Q. And would that report designate what part was sales made by Air Reduction Sales Company and what part was cash collected on sales made by National Carbide Company?

A. That would show up on the daily sales report form, not on the bank deposit slip itself.

Q. Not on the bank deposit?

A. Because very often a customer's check would cover payment for two or more products.

Q. And would appropriate entries be made between the companies where that occurred?

A. Yes, sir.

Q. To give credit to the company that was entitled to the cash that had been deposited in the other company's account?

A. Yes, sir.

[fol. 172] Q. Was this chart, Petitioner's Exhibit 22, made up in the departments under your supervision?

A. These were the departments—I didn't understand you.

Q. Was this made up in one of the departments under your supervision, this chart?

A. No; I don't know where it was made up.

Q. Do you know what the occasion was for making a new chart in 1938?

A. We have periodic charts. I don't know as to this particular one. We have got charts going all the way back through the various stages of the company.

Q. Do you recall why this one was made up in 1938?

A. No; I do not.

Q. Now, these accounts you call inter-company accounts, that is where it appears, for instance, as an account receivable on the parent company's books and an accounts payable on the subsidiary's books. I suppose that is the type of account you meant when you spoke of inter-company account?

A. That is right.

Q. Restricting it to those, did those accounts contain substantial amounts?

A. You mean——

Q. For instance, take the accounts between the Air Reduction Sales Company and Air Reduction Company, Inc.

A. Yes, they were substantial accounts.

Q. How substantial were they? In 1938, let us say.

A. I would have to check that figure. I don't remember now.

Q. What was the account composed of? What was generally debited to that account?

A. Well, the original debit, I presume, was for working capital. And the subsequent deductions by payment from the subsidiary to the parent were made against that. All charges between the two companies were cleared through that account, charges and credits, I should say.

Q. Well, let us take the account payable on the Sales Company's books. How did the account originally arise, as an account payable?

A. The account payable on the Sales Company's books.

[fol. 173] Q. Air Reduction Sales Company's books.

A. Well, it was originally arrived at by the Air Reduction, Inc., advancing working capital to Air Reduction Sales, I assume.

Q. Was there anything else put into that account?

A. Everything has been put in that account since we have gone through. I don't know that I understand your question, but all charges were put in that account.

Q. Isn't it a fact that when plants were transferred from Air Reduction Company to Air Reduction Sales Company, that those also were credited to that account payable?

A. They were.

Q. And the account payable account bears a very close relationship to the assets that appear on the balance sheet of the Air Reduction Sales Company; isn't that true?

A. I would like to look at one. I think it would have a sizeable portion of it. In view of the fact that Air Reduction Sales owed everything except its service fee to the parent, I should think it would be very close to that figure.

The Court: We will take a ten-minute recess at this time.

(A ten-minute recess was taken.)

The Court: Proceed, Mr. Maddox.

By Mr. Maddox:

Q. I show you a paper and ask you if you can identify that.

A. That is the Tax Return for 1938 for Air Reduction Sales Company.

Q. Now I refer you to page 4, which contains comparative balance sheets for the beginning and end of the taxable year, and ask you if that refreshes your recollection with reference to the question I asked you before, about the comparison of the Account Payable Account with the total Assets?

A. Whether it is substantially the same?

Q. Yes. Read the figures off; what are the total Assets?

A. Total Assets at the beginning of the taxable year was $16,532,724, and at the end of the taxable year it was $16,663,233.

The Accounts Payable figure, at the beginning of the taxable year, $16,061,812, and at the end of the taxable year, $16,248,362.

[fol. 174] Q. Now that Account Payable that we have just referred to, that was originally made up by the advancement of working capital to the Air Reduction Sales Company?

A. Yes, sir.

Q. And also a charge for the plants that were turned over to Air Reduction Sales Company?

A. Yes, sir.

Q. And it has been increased over the years by accumulated earnings?

A. No. Are you speaking of the accumulated earnings of Air Reduction Sales Company? The amount of its fee, that is the only increase.

Q. What was your statement?

A. I said the only increase in the agency company comes from its earnings through its annual fee.

Q. In other words, the credit—you have credited to that account in each year the results of the operations of Air Reduction Sales Company in excess of the 6% on the nominal capital stock, isn't that true?

A. No, that is not true. The only income that the Air Reduction Sales Company has had, has been its 6%——

Q. I am asking you with reference to the Account Payable that we have been referring to.

A. Well, we might add to it, or we might take away from it, depending on the operating requirements.

Q. Well with respect to the profits from the result of the operations by the Air Reduction Sales Company, have they not, in excess of 6% on nominal capital stock, been credited to that account?

A. No, those have been taken through the Account Payable to Air Reduction, Inc.

Q. I didn't understand you.

A. The profits of Air Reduction Sales in excess of the 6% has been, or becomes an Account Payable on the books of Air Reduction Sales Company, and an Account Receivable on the books of Air Reduction Company, Inc., and such proportion of that as has been required for the business of Air Reduction Sales has been allowed to remain there.

[fol. 175] Q. Well now, you misunderstand my question. Profits from the operation of the assets that appear on this balance sheet of Air Reduction Sales Company, exceeding 6% of the $12,500 capital stock of Air Reduction Sales Company shown on this balance sheet, have been credited, in this Account Payable that you read off from this balance sheet, isn't that correct?

A. That is true.

Q. And it is in that Account Payable to the extent that it has not been paid out by the Sales Company to Air Reduction Company, Inc.?

A. That is right.

Q. And that condition has existed for a long number of years, has it not?

A. Yes, sir.

Q. And why wasn't that Account Payable paid?

A. Do you mean in cash?

Q. In any form.

A. Because the operation of the Sales company required

the use of that capital in its operations, under the contract.

Q. And to pay that, what would have to be done?

A. At any given moment? Is that what you mean? Rather than let it——

Q. At any time during the course of the years it has been running.

A. Why, I suppose you would have to liquidate the company in order to pay it off.

Q. And did you charge any interest in this account?

A. No, sir.

Q. With that balance?

A. No, sir.

Q. In other words, that is a net amount, without any interest taken into consideration?

A. That is right.

Q. And that is true of all years?

A. That is right.

Q. And isn't that also true of the National Carbide Company?

A. It is true of all the agency companies.

[fol. 176] Q. It is true of Wilson Welder, National Carbide, and Pure Carbonic, Inc.?

A. Yes, sir.

Q. But it is not true of the Magnolia Airco Gas Products Company?

A. Magnolia Airco Gas Products Company operates as a separate company and not as an agency company, and to that extent does not have that clearing account. Profits of Magnolia are declared out in dividends to Air Reduction Co., Inc.

Q. And the accumulated profits appear on their balance sheet in what form, as a surplus?

A. As a surplus, yes.

Q. And that is also true of the Crystal Carbonic Co., Inc., of Texas?

A. I don't remember the figures for Crystal Carbonic as of 1938, but I think it was true as of 1938.

Q. Is it also true of Commercial Acetylene & Supply Company, Inc.?

A. Commercial Acetylene was almost in liquidation in 1938, and it has all been liquidated since that time. There was only a small amount left there.

Q. I refer you to the return of Crystal Pure Carbonic, Inc., of Texas, and ask you if you can say that the same

condition prevailed with respect to that company as prevailed with Magnolia Airco Gas Products Company?

A. I am sure it did.

Q. What is the answer?

A. I am sure it did.

Q. With reference to Commercial Acetylene & Supply Company, Inc., is that also true?

A. That is true.

Q. That is, the same condition prevails there as with respect to Magnolia Airco Gas Products Company?

A. Yes.

Q. Do you say that Company has since been liquidated?

A. It is practically liquidated. All the business was taken over by Air Reduction Sales Co., and there is only a small operation left. It was in the process of liquidation in 1938. That is true, yes.

[fol. 177] Q. You mentioned the question of drawing off cash from the different subsidiaries, and perhaps putting it in either the Airco bank account or one of the other subsidiary bank accounts. What were the normal operating requirements, for instance, in 1938, of Air Reduction Sales Company?

A. Well, I can't answer that in total. Operating requirements were set for every plant, every district office. At that time we had about 150 bank accounts in plant towns, and a requirement was set for each one of those. I don't know what the total would be now.

Q. Well, referring again to the balance sheet of Air Reduction Sales Company, at the beginning and end of the year, there is approximately $3½ million of cash that appears there. Was that a normal requirement of Air Reduction Sales Company?

A. I don't know what the fluctuations were within the year, but I would assume that that was a normal requirement for their business at that time.

Q. And of course your working capital would take into consideration other items than cash, would it not?

A. Yes, it would.

Q. With respect to Petitioner's Exhibit 34, which pertains to the Retirement Income Plan, I refer you to the photostats of the cheques, one to Aetna Life Insurance Company and the other to Bankers' Trust Company, and I refer you to the lower part, which is commonly called the voucher part of the cheque, isn't that right? Isn't that a voucher cheque?

A. Yes, sir.

Q. I refer you to the column headed "distribution," and then under that, a heading, "general," and then underneath that "Ac. number," and an amount, and I will ask you to explain that column.

A. I can't remember what the account numbers are.

Q. Well, does that designate, that "distribution"——

A. On the Aetna Life Insurance Company, it would undoubtedly identify the pay roll from which those charges were accumulated.

Q. And what pay rolls would those be?

A. Those would be of Air Reduction, Inc., and the four subsidiary companies.

[fol. 178] Q. And the different companies?

A. That is right.

Q. In other words the total amount of this cheque, then, would be entered on the various accounts of the various companies, is that what I understand that to be?

A. It would be broken down in accordance with their own employees.

Q. With their own employees?

A. That is correct.

Q. That is also true over here, with respect to the other cheque in this exhibit?

A. Yes, sir.

Q. In other words, that is the accounting distribution to the various companies, of the amount of that cheque?

A. That is correct. Would you like to have me explain a little bit more about that? On the Aetna Life Insurance Company payment, that represents a part of the employee's money and a part of the company's money.

Q. Yes?

A. The employee having had this deducted from his pay, and this monthly accumulation of that is then taken and added to by the company's portion, which becomes the total amount paid to Aetna for future service.

Q. But that has nothing to do with the distribution? The distribution remains?

A. That is correct.

Q. Mr. Keeley, do I understand your testimony to be that the books of the various companies have been kept so that charges that are directly attributable to the operations of any particular company are charged to that company, and

those that are not have been properly allocated, or apportioned to each company?

A. No, with regard to a large portion of the administrative expense of Air Reduction Company, Inc., it is never charged to the agency company. That is carried as a charge of Air Reduction Company, Inc.

Q. Not on the books?

A. On its books.

[fol. 179] Q. That is, the amount that has been allocated by the Commissioner in the proceedings here?

A. I don't know whether it agrees with that amount.

Q. You are not acquainted with that?

A. I am not acquainted with that.

Q. Now, there was some mention made in your direct examination about subsidiary records in the field. The term "subsidiary" in that instance was not with reference to the subsidiary company, but a record that was subsidiary to another record, isn't that true?

A. That was my understanding of the question.

Q. Yes. Now, you said transfers have been made, of property and supplies, perhaps, at the then book value?

A. At the depreciated value on the books of the agency company.

Q. You meant at the value of the depreciated property?

A. That is right.

Q. And wherever expenses have been paid by one company on behalf of another, the proper charge has been made between the companies, isn't that correct?

A. Well, generally, that is true. But in some of the cases that I spoke about, such as these items that are hard to pro-rate, they have not been so charged.

Q. That is the administration expenses?

A. Well, there is stationary, and things of that sort, that have been used by all companies, that has never been pro-rated to the agency company.

Q. Now, the rent of the Lincoln Building. Who pays that rent?

A. I think the rent bill is to Air Reduction Sales Company. I think.

Q. And are appropriate charges made from the Sales Company to the other companies for space they occupy?

A. It is my impression that the other agency companies are charged with their square foot area of space, with Sales Company paying the bill. That is my recollection.

Q. Well if I understood your statement on direct examination to be otherwise, I was wrong, then? The correct [fol. 180] understanding is that the rent was paid by Air Reduction Sales Company, and then appropriate allocations made to the other companies for the space they occupy?

A. I am sure that is true in so far as the other agencies are concerned; I am sure that is true.

. . . . . .

(Tr. pp. 332-345.)

GEORGE E. HAWKINS, a witness on behalf of the petitioner, was duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Will you state your name, please?

A. George E. Hawkins.

Mr. Wilson: Your Honor, I should like to say this for the record: I gathered from some of Mr. Maddox's questions with reference to this functional chart, Petitioner's Exhibit 22, that he was of the understanding that that chart had been made in 1938 and was in use in 1938. I think his understanding may have been founded on something that Mr. Gibson said this morning.

I am not sure whether I heard Mr. Gibson correctly, but if he said it was made in 1938 he was in error, and I would like to correct it.

This chart represents the organization and functions of Airco as they existed in 1938, but my understanding is that there was no Airco functional and organizational chart in existence and in use in 1938.

Now, if it should be necessary, and if Mr. Maddox would like to have me do so, I will be happy to put on the witness stand the man who got that chart up, as an accurate reflection of conditions in 1938, and have it authenticated in that way. But I don't want Mr. Maddox to labor under a misapprehension in that respect.

Mr. Maddox: Do I understand you to say that this chart did not exist in 1938?

Mr. Wilson: The chart as such was not prepared in 1938—that is, Petitioner's Exhibit 22—but it is, we believe, and accurate reflection of the organization and the functions which it purports to set forth during the year 1938.

[fol. 181] I should like to say that, with one slight matter which has been called to my attention, with reference to Mr. MacArthur, who appears, Mr. Maddox, in the Distribution Branch set forth in the chart—I understand that the name MacArthur set forth there is in error, and that there was a Mr. Keevins who held that position in 1938, and that in March, I believe, of 1939, Mr. MacArthur came in—and that is the only correction that I am aware of that needs to be made in the chart.

But I say to you, that if you would like to have us produce the man who actually compiled this chart, I will be glad to do so.

Mr. Maddox: All I have to say to that, and for the record, at this time, is that I don't accept your statement as evidence of those facts.

Mr. Wilson: I didn't expect you to, sir.

Mr. Maddox: If you want to clear this record up on that point, it has to be done by legal evidence. If it is not, then I will have to take appropriate action at the proper time.

Mr. Wilson: I have already indicated that I will be glad to go as far as you want me to go in clearing that up.

Mr. Maddox: It is a matter for you to clear up, not for me.

Mr. Wilson: I understand that.

The Court: I may say this: inasmuch as the chart is an exhibit representing the organization of the Air Reduction Company and its subsidiaries in 1938, that I think it would be well for you, Mr. Wilson, to show when and how it was prepared, and that it does correctly represent the organizational set-up of the parent company and its subsidiaries in that year.

Mr. Wilson: Yes; I will go further in that direction than has been done already, your Honor. I did introduce the chart through Mr. Randall, who said that he, in his capacity as Vice President in charge of the Corporate Branch, was familiar with the set-up in 1938, that he was thoroughly familiar with this chart, and that he had examined it and that to the best of his knowledge and belief it was accurate, but I shall go further and put on the man who actually prepared this chart.

The Court: Yes. I think, of course, that it would not be necessary for the chart to be in existence in 1938, if it represents the organizational set-up, and, as I have understood, [fol. 182] all the witnesses that have testified thus far, have verified this set-up.

Mr. Wilson: That is exactly my thought in putting it in, as a handy summary of the situation, and it has been verified by each witness who has been on the stand and who has testified with reference to it.

Mr. Maddox: I would like to make this observation for the record.

The Court: Very well, Mr. Maddox.

Mr. Maddox: That each witness, perhaps with one or two exceptions, has borne heavily on this chart as refreshing their recollection. That has been my observation of the use of this chart; it had a very definite bearing on their testimony. Their recollection was refreshed by it, apparently, rather than testifying independently.

The Court: Well, of course, there has never been any suggestion but what the chart correctly represents the organizational set-up. However I think it would be well if you would produce the witness who prepared it, Mr. Wilson.

You may proceed.

Direct examination.

By Mr. Wilson:

Q. Mr. Hawkins, what is your present position in the Air Reduction Company, or in any one or more of its subsidiaries? That is, as of the present date?

A. Vice President in charge of Distribution.

Q. And in 1938, did you occupy various positions in Air Reduction Company, and in the subsidiary companies?

A. I did.

Q. What were those positions?

A. Assistant Vice President of Air Reduction Company, Inc., Air Reduction Sales Company, and Vice President of Pure Carbonic Corporation.

Q. How long, in all, has your connection with Air Reduction Company extended?

A. Since February, 1917.

Q. And what was the general branch of Air Reduction Company's activities of which you were in charge, in 1938?

A. Distribution and traffic.

[fol. 183] Q. Now, did you, during 1938, have various individuals reporting to you, in your general capacity as supervisor of traffic and distribution functions?

A. I did.

Q. Will you tell us what individuals reported to you during that year, and what particular phase of distribution and traffic matters each of those individuals handled?

A. Mr. S. B. Stouffer was Assistant Distribution Manager; he handled the distribution of all products from plants and warehouses to customers.

Mr. T. P. Keevins was traffic manager for all companies except Pure Carbonic; he handled all the traffic problems, rates, auditing of all freight bills, and other details of traffic.

Mr. E. C. McClintic was Traffic Manager for Pure Carbonic; he handled mainly the Dry Ice, steel tubes, all the traffic handled in leased cars, or standing in warehouses, and tracing.

Mr. H. B. Welsh, Truck Supervisor, had charge of the maintenance and traffic of all the truck fleet.

Q. For all the companies?

A. For all the companies.

Q. It is correct that each of these men you have mentioned, in the functions you have mentioned, operated and performed services on behalf of all the companies?

A. All except Mr. McClintic.

Q. Yes. First let us take up Mr. Stouffer, who, as I understand it, was the Assistant Distribution Manager in charge of distribution for all companies, in 1938. Will you just tell us, in your own way, how the distribution functions for these companies were handled, Mr. Hawkins?

A. We have in the Districts, a distribution superintendent who reports to the District Manager for Personnel, Discipline, and reports to Mr. Stouffer for methods and procedures. Through these distribution superintendents, Mr. Stouffer handles all of our products, from our plants and warehouses to our customers, and the return of empty steel containers where gasses are involved.

Q. You say: "All of our products". Are you generally referring to what have been called here "Airco Products"?

[fol. 184] A. Yes, sir.

Q. Now, can you tell us something of how the storage matters were handled in 1938 and in other years, that is the storage of these Airco Products?

A. Wherever we had facilities, the products were all handled at the same location; at the plants. Where we did not have facilities, there might have been two or three locations where certain products were handled. At warehouses, in some cases all products were handled and in some other cases we had separate warehouses for separate products.

Q. And how were the trucks used with respect to the products of the various subsidiaries, or the products that were produced by the various subsidiary companies?

A. When we had orders for delivery of our products, regardless of the product, and we had a truck going into that area, that truck took all products.

Q. Will you just give us a little concrete picture of what a truck might carry in that situation?

A. Well, a truck might carry oxygen, acetylene, nitrogen, carbon dioxide, cylinders, all kinds of welding rods, electric and gas welding rods, maybe an electric welding machine, and perhaps some dry ice.

Q. In other words, it might carry the products that were manufactured by any one of these subsidiary companies?

A. We did not differentiate.

Q. Now, as to the next section under your general supervision—that headed by Mr. McClintic the Pure Carbonic Company Traffic Manager. Was he in charge of that section during 1938?

A. He was.

Q. Will you tell us just how he operated during that year, under your supervision?

A. We handled deliveries in leased refrigerator cars, especially prepared for handling dry ice; he handled all those cars from the loading points to the warehouses, routing, tracing and return of empties for refilling. It was his particular job to keep all of the dry ice warehouses supplied with dry ice from the manufacturing plants.

[fol. 185] He also handled dry ice freight, and the tracing of carbon cylinders when there was tracing to be done.

Q. Do I understand you correctly to say that Mr. McClintic handled the traffic in dry ice from the plant to the distributing warehouse?

A. To the warehouse, yes, sir.

Q. Did somebody else handle the distribution from that point on?

A. Mr. Stouffer.

Q. Just tell us about that.

Q. From the plant or warehouse through the distribution superintendent reporting to Mr. Stouffer for methods and procedures, all products were delivered to customers in the plants and warehouses. In some cases we had route trucks, where a truck would go out loaded with our products, as a peddle route, to sell on the route whatever the customers desired to have.

Q. The next section under your general supervision in 1938 is the General Traffic Manager's Section. Who was in charge of that during 1938?

A. Mr. T. P. Keevins.

Q. Did Mr. MacArthur, at a later time, become General Traffic Manager?

A. Yes, in the early part of 1939.

Q. About when in 1939, if you recall?

A. February or March.

Q. What were the functions performed by Mr. Keevins as Traffic Manager?

A. All the traffic functions for all companies with the exception of Pure Carbonic, and the auditing of all freight bills, including Pure Carbonic.

Q. And Mr. Keevins reported to you throughout 1938?

A. Yes, sir.

Q. The last section is that of Truck Supervision. Who was in charge of that section of your Department throughout 1938?

A. Mr. H. B. Welsh.

Q. Tell us what functions he performed.

[fol. 186] A. His function was to write the specifications for the equipment we needed, and when the equipment was obtained, to operate it and maintain it.

Q. And the equipment that you are referring to is trucking equipment?

A. Yes, sir.

Q. And did he operate or inspect those trucks and maintain them on behalf of Airco and the four subsidiaries?

A. Yes, sir.

Q. And he was accountable to you as Assistant Vice President of Air Reduction Company, is that right?

A. That is right.

Mr. Wilson. Your witness.

Cross examination.

By Mr. Maddox:

Q. Mr. Hawkins, where were these four men located? Stouffer, McClintic, Keevins, and Welsh, in 1938?

A. 60 E. 42nd Street.

Q. They had offices there?

A. Yes, sir.

Q. And where were the different products distributed from?

A. Throughout the United States.

Q. Numerous officers?

A. Many plants and warehouses.

Q. And just what did they do with reference to that? They didn't do it personally, did they?

A. It was under their supervision.

Q. They were the supervisors for the whole country, is that the idea?

A. That is right.

Q. I suppose that for that purpose they had numerous employees under them, didn't they?

A. In the field.

Q. Yes. Each one of them?

A. We had a man in each District who reported to these particular men for their functions, known as the distribution superintendent in each district.

Q. They sat in their offices here in the Lincoln Building, did they not, and received reports, largely? Isn't that true?

A. They spent a good portion of their time out in the field.

[fol. 187] Q. Out in the field?

A. Supervising the work; yes, sir.

Q. With reference to the use of trucks, you said a truck might go out loaded with oxygen and acetylene and nitrogen. That was only in particular locations where that was feasible, was it not? Would that be true here in New York?

A. In New York City.

Q. In the New York territory?

A. In New York, a truck would handle all products with the exception of dry ice. Very seldom would dry ice be put on the same truck, but all other products would be.

Q. Well I have, in the course of time, observed trucks, particularly in the evening, with "Air Reduction Sales Company" on it, and loaded with big drums or tanks, or whatever you call them, going clanging along the street, practically every evening, and going over to Jersey. Are they indiscriminately hauling oxygen, nitrogen and pure carbonic products?

A. The trucks you saw would have all products on them with the exception of dry ice. They would probably not have dry ice on that particular truck.

Q. Is there not a regulation that you can't carry certain gasses along with other gasses?

A. Not if you comply with those regulations.

Q. There are regulations that are restrictive, though, are there not?

A. Not if the cylinders and containers meet your ICC specifications. Not any of our gasses.

Q. Are not some gasses explosive, and others not?

A. Yes, sir, that is so.

Q. And there are regulations with reference to explosive gasses?

A. Yes, sir.

Q. I have seen trucks travelling around the streets of New York with "Pure Carbonic, Inc." on them, containing smaller drums. Did they have oxygen tanks on them too, here in New York?

A. They might have had. We keep a stock of oxygen at the Pure Carbonic Plant.

[fol. 188] Q. Well would they be delivering oxygen along the streets here, of New York?

A. They might be, yes, sir, depending on where——

Q. Was that done here in New York?

A. I. 1938?

Q. Yes, in 1938.

A. Yes, sir.

Q. Do you know that to be a fact?

A. Yes, sir.

Q. When that was done, do you know anything about the accounting with reference to it?

A. In what way?

Q. How the expense of the truck was allocated?

A. We tried to keep our truck cost as close as we could to the product the truck was handling.

Q. Is there any significance in the fact that you appear as a Vice President of Pure Carbonic, Inc.? Were you with them before you were connected with Air Reduction Co. and Air Reduction Sales Co.?

A. No, sir.

Q. You were not with them when they were a separate and distinct company, and not a wholly-owned subsidiary?

A. I was not.

* * * * * * * *

FLOYD J. METZGER, a witness on behalf of the Petitioner, was duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. What is your present position with Air Reduction Company, Mr. Metzger, or any one or more of the subsidiary companies at the present time?

A. At the present time I am Vice President in charge of Liquefaction Research and Development.

Q. How long in all has your service with Air Reduction Company extended?

A. Since February, 1917.

Q. And in 1938, what official positions did you occupy with Air Reduction Company, or with any of its subsidiaries?

A. I was then Vice President in charge of Chemical and Liquefaction Research.

[fol. 189] Q. Doctor Metzger, in 1938, did you have various men reporting to you in your Research Department?

A. Yes.

Q. Will you just tell us what the sections of that Research Department were in 1938, and who was in charge of each section?

A. Well in any research organization, you have various branches, headed up by specialists. For example, anything that pertained to mechanical operations was headed up by Mr. Wilkinson. Mr. Fogg was our Chief Chemist and headed up the particularly chemical features.

Mr. Balcar was also one of our employees and specialised particularly at that time in the rare gases.

Dr. Van Nuys was our Chief Physicist and Thermo-Dynamics man. Those were the principle divisions.

Q. What company or companies did this research department which you headed, serve or function for, during the year 1938?

A. Any or all of our affiliated companies.

Q. Did it function for Air Reduction Company?

A. Yes.

Q. Pure Carbonic?

A. Yes.

Q. National Carbide?

A. Yes.

Q. Wilson Welder?

A. Yes.

Q. And the Air Reduction Sales Company?

A. Yes.

Q. That first section under Mr. Wilkinson, was that commonly known as the Chemical Engineering Research Department?

A. Yes, I would call it that.

Q. Will you just give us a brief account of the type of research that that particular section of your Department was engaged in in 1938.

A. Well, we investigated and carried on research on any problems that we thought would be to the benefit of the [fol. 190] Company. We had no specific limitations in the research work that was done.

Q. I think you have said that you engaged in chemical research as one phase of your departmental activity. Will you just give us a few concrete indications of the type of chemical research that you engaged in in 1938, and other years, and the objects of that research?

A. Well, for example, alcohol was considered a worthwhile subject. We carried on extended research in connection with the production of synthetic alcohol, and developed a large number of patents on that subject.

Q. What was the type of your research in the liquefaction field? I understood you to mention that as a type of your research.

A. Well, the object, of course, in that, was to improve both processes and products in our general manufacture, by devising new cycles, so called, flows of gases through our

various and sundry apparatus, and improvements of the product.

Q. How long has that liquefaction research been going on in your general research department, approximately?

A. Since 1917, and it is still going on.

Q. What is the general purpose of that particular type of research, the liquefaction research? What do you do?

A. Well, primarily we work for our main product, which is oxygen, and also nitrogen; we process air—air being composed of nitrogen, roughly speaking, four-fifths, and oxygen, one-fifth. We separate the oxygen for our cutting and welding operations.

Q. And is that phase of your activity also to further developing process for the distillation or extraction of the socalled rare gases from the air?

A. Yes.

Q. Are there various laboratories that are maintained and used in connection with your research functions?

A. I don't quite understand your question.

Q. Do any laboratories operate under your general supervision?

A. Well, it is a general laboratory and it operates as one.

[fol. 191] Q. Where are these laboratories located?

A. Stamford, Connecticut.

Mr. Maddox: Where?

The Witness: Stamford, Connecticut.

By Mr. Wilson:

Q. And what particular type of research does that laboratory at Stamford engage in?

A. Just such types as I have mentioned: chemical, liquefaction, and so on.

Q. Do you also have laboratories in Jersey City?

A. Yes.

Q. And what do those laboratories engage in? What type of research?

A. Well their research is primarily apparatus and equipment used in connection with our business.

Q. Would it be true to say that those laboratories devote themselves primarily to mechanical and engineering research?

A. Practically entirely so.

Q. I think you said a little while ago that one of the objects of your research was to endeavor to improve the quality of Airco products, is that right?

A. That is right.

Q. Have you endeavored, in the course of your rather long researches, to improve the quality of oxygen?

A. Yes, indeed.

Q. Will you tell us, just in your own way, what your research department has done in that connection?

A. Well I might start out by saying that when we first entered the business, in 1915 or 1916, and for some years thereafter, oxygen that we sold in those days had a purity of roughly speaking approximately 98%, sometimes 98.5%.

It was found, in early days, that a higher purity oxygen would do a much better job, and that the customer would be more satisfied with it. It was found, further, that about a 99.5% oxygen, instead of 98% or thereabouts, would improve cutting operations even as much, probably, as 20% or 25% in the hands of the consumer.

[fol. 192] It was one of our early jobs, at that time, to see whether we could make a 99.5% oxygen. We tried it in our regular equipment, and we found that our production, or our output per unit of plant might vary anywhere from 40% to 60% or 70% of its normal output if we had to produce the higher purity gas. We immediately entered upon investigations, researches, set up apparatus, and equipment, and after long struggling, we found that we could produce a 99.5% oxygen. Immediately thereafter, we revamped practically all, in fact all, of our units scattered about the country, and from that time on, and even to the present time, have sold oxygen of a 99.5% purity.

Q. Has your department also moved ahead in the development of the so-called rare gases?

A. Yes.

Q. Will you just tell us concretely a little bit about what has been done in that field?

A. Well, at the present time and for some years past, we take out all—or all that we can market—of the so-called rare gases, argon, neon, helium, krypton, and zeon. We developed the processes for getting them out and methods of purification and methods of application.

Q. How is argon, for example, used?

A. Well, I suppose at the present time, not being in the sales department, perhaps the largest use for it is incan-

descent light bulbs, such as these are here, I presume. Those were originally made with a carbon filament and a vacuum. It was later found that substitution of the vacuum by nitrogen—in other words, to fill the bulb with nitrogen instead of the vacuum would considerably improve the efficiency of the lamp, 20 or 25 percent, or somewhere in that neighborhood.

We produced this nitrogen, worked out methods of purification and so on and then marketed that.

Soon after it was discovered that there was something better than nitrogen for use in the bulbs and that was argon. We then developed means for making and purifying argon, to the highest degree of purity, and that was substituted and is now used almost universally instead of nitrogen in these incandescent light bulbs. That again improved their quality and efficiency by 20 or 25 percent.

[fol. 193] And within the last, I should say, six or eight years, or more, it has again been discovered that krypton and zeon, the very *fare* gases, give about the same improvement over argon that argon gave over nitrogen and that nitrogen gave over the vacuum bulb, and for that it is a question of whether there is enough available in the air, or, rather whether it can be taken out of the air in quantities sufficient to allow its use for a general replacement. There is only about one part—there is only about one cubic foot in a million cubic feet of krypton in the air, and there is about one cubic foot to about ten million or eleven million cubic feet of air, which means that it would be rather expensive.

Q. Will you give us an illustration of the type of service that your research department has rendered in the calcium carbide and the acetylene field, generally?

A. Well, in the calcium carbide field, we have rendered a great deal of service to the Carbide Company, in connection with the consumer customers. Wherever there was difficulty, the problem came to us and we did our best to solve it. We have sent men into our carbide plants—some of our research men—to study the methods of production, to study the physical properties, to take samples at various stages of the operation, to hunt for improvements, and difficulties that might arise therefrom.

Q. Can you illustrate for us the type of research and development which your department has engaged in in connection

with the carbon dioxide activities of the Air Reduction Company, Inc.?

A. We have done a great deal of work for the Pure Carbonic Company. They have no chemical or research department of their own. I might add also that neither has the Carbide Company a research department of their own. So that all their troubles and problems came our way.

We had, for a number of years, in 1938 and prior to that, a great deal of trouble with odor in certain of our carbon dioxide. That is something that can't be tolerated because most of the carbon dioxide goes into the preservation of foods and beverages, carbonation of water and all sorts of soft drinks, and we have done a great deal of work along that line.

[fol. 194] We have also done a great deal of work in connection with the manufacture of dry ice, and in the production of dry gases, which is an absolute essential for certain uses, such as in refrigerating machines.

Q. Can you illustrate for us the type of research and development in which your department has engaged with respect to the products of Wilson Welder and Metals Company?

A. Well, we have done quite a good deal of work for Wilson Welder and Metals Company. We have analyzed and tested not only their own welding rod equipment, but also that of competitors, for the purpose of getting a comparative evaluation of them. We spent a great deal of time in developing coatings which are used on electrical welding rods, and actually developed new coating materials and processes and procedures to be followed in their manufacture.

Q. Does your department, the research department, perform certain functions in connection with the Air Reduction Company patents?

A. Yes.

Q. Will you just tell us briefly what your functions in that connection are?

A. Well, there are primarily two functions. One is to look after all of our own patentable material. And the second is to pass on, study, and in many cases try out processes or products that are brought to us with the thought that we might be interested in them.

Q. So that, would it be true to say that your research department functions in the scientific and research field on

behalf of Airco and its four subsidiary companies, and in connection with all the so-called Airco products? Is that right?

A. It is.

* * * * * * *

(Tr. pp. 360-367.)

J. D. STETSON, JR., called as a witness on behalf of the Petitioners was duly sworn and testified as follows:

The Clerk: What is your full name?

The Witness: J. D. Stetson, Jr.

[fol. 195] Direct examination.

By Mr. Wilson:

Q. Mr. Stetson, are you employed by Air Reduction Company, Inc.?

A. Yes, sir.

Q. In what capacity or capacities?

A. I am assistant to the director of the Bureau of Relations and assistant treasurer of the company for signing purposes.

Q. How long have you been connected with Air Reduction Company?

A. Since February, 1935.

Q. In your capacity as assistant to the Bureau of Relations, what are your functions, briefly?

A. Personnel and administration work and administrator of the company pension plan.

Q. I show you a chart which has been marked Petitioner's Exhibit 22, Mr. Stetson. Did you prepare that chart?

A. I gathered the information and turned it over to one of my girls who drew up the chart; that is correct.

Q. How did you come to take care of the preparation of the chart in that way?

A. By references to departmental charts in the file, by references to bulletins, inter-company bulletins, announcing changes in the organization set-up, and by discussing with the other executives of the company the functions of the officers at that time, 1938.

Q. Well, before you began the preparation of the chart, did you investigate to ascertain whether or not there had been in use and in existence in 1913 an organizational and functional chart of Air Reduction Company?

A. 1938.

Q. I beg your pardon. 1938.

A. I investigated and found that there was no chart at that time.

Q. Then did you proceed to prepare this chart?

A. That is right.

Q. After it had been put in the form in which it now appears, did you review it?

A. I reviewed it and checked it with some of the executives of the company.

[fol. 196] Q. Can you tell us who some of those executives were?

A. I can. Mr. Keeley, I went over the chart with Mr. Keeley after it was prepared. I discussed it over the phone with Mr. Harrison.

Q. Who is Mr. Harrison?

A. Assistant secretary of the company.

Q. Do you happen to know how long Mr. Harrison has been connected with Air Reduction Company, Inc.?

A. I think it was 1918 that Tom came with the company.

Q. And is he one of the men who is in the corporate branch of Air Reduction Company, Inc.?

A. He is.

Q. To the best of your knowledge and belief, is that an accurate representation of the organization and the functions of the executive boards of Air Reduction Company and its branches as they existed throughout the year 1938?

A. Yes, it is. It is, to the best of my knowledge and ability to prepare this chart as to the officers for 1938, it is correct.

Q. Is there any exception to which you want to call attention with relation to the distribution department?

A. I find that I must have made one error in that Mr. McArthur was not assigned his job as general traffic manager until March, 1939. That is the only error which has been called to my attention.

Q. And instead of Mr. McArthur's name appearing where it does appear on the chart, what other name should be substituted?

A. Mr. Tom Keevins.

Q. Other than the one mistake to which you have just called attention, have any other errors or mistakes come to your attention since your preparation of that chart?

A. No, sir.

Q. That is all.

Cross-examination.

By Mr. Maddox:

Q. Mr. Stetson, when did you prepare this?

A. July, 1945.

Q. And at whose suggestion?

A. At the suggestion of one of the attorneys. He came to me and asked me did we have a company organization chart [fol. 197] for the year 1938. After investigation I told him that we did not have one.

Q. And who was that attorney?

A. Mr. Robinson.

Mr. Wilson: May the record show that Mr. Robinson is my associate here at the trial?

The Court: Yes; I understand that.

By Mr. Maddox:

Q. And you started preparing that chart in July; is that when you started on it?

A. To the best of my recollection.

Q. And when was it completed?

A. The first part of September, as I recall.

Q. From what sources did you gather the information that is shown on this chart?

A. Inter-company organization bulletins.

Q. Did you consult the records of the company?

A. The pay roll records, yes, sir. I consulted the departmental——

Q. Anything else in the way of records?

A. The departmental charts which we had.

Q. Do you have those with you?

A. No, sir; I do not. They are available.

Q. Where did the general plan of the chart come from? Is that yours?

A. It is. That is the organization as it was set up in those days.

Q. This is your visualization of the organization from information you gained by consulting records and interviewing individuals?

A. That is right, sir.

Q. And, as a matter of fact, there never was a chart existing in 1938 or at any other time, such as this chart, was there?

A. Not until 1940. There was in 1940.

Q. There was in 1940?

A. But not in 1938 nor prior to that to my knowledge.

Q. And, of course, your knowledge only runs back to 1935 when you first came with the company, doesn't it?

[fol. 198] A. That is correct.

Q. And no further than that?

A. That is correct.

Q. Now, you mentioned Mr. Harrison. You discussed this chart with Mr. Harrison. Why did you discuss it with him?

A. He had available the corporate records with respect to the officers, the directors, and other information which would, I thought, be helpful in the preparation of the chart.

Q. And just what records are those? What records are those which you are referring to that he had?

A. He had records as to the appointment of the directors of the subsidiary companies, and the appointments as to officers and directors of the parent company.

Q. And did you examine those records yourself?

A. Yes, sir.

Q. Well, why did you consult Mr. Harrison, then?

A. Why did I consult him?

Q. Yes; if you examined them yourself.

A. He had them all in one place; all available in his office.

Q. Well, what did your consultation with him consist of, then?

A. Going over those records and putting them down in black and white.

Q. Well, is what appears here your interpretation of those records, or his?

A. Mine.

Q. It is yours?

A. Yes; based on the facts as shown in his records as well as my own.

Q. On the basis of what knowledge—you went with the company in 1935, and on the basis of what knowledge did

you testify that Mr. Harrison has been with the company since 1918?

A. Well, on the basis that he is, in the first place, a rather old man, and I know Tom pretty well.

Q. Well, how old are you?

A. 33 years old.

Q. So that you were how old in 1918? Do you recall?

A. Six years old.

[fol. 199] Q. How did it happen that you got Mr. McArthur's name instead of Mr. Keevin's name?

A. It is a mistake.

Q. Just a pure mistake; that is your only explanation?

A. That is the only way I can account for it, just an error on my part.

Mr. Maddox: That is all.

Mr. Wilson: No further questions.

Mr. Maddox: On the basis of the record here, I move that Exhibit 22 be stricken out. It is wholly hearsay. It has no relevancy to any issue in this case; its authenticity has not been established, and its accuracy has not been established.

The Court: I will overrule the objection and deny the motion to strike.

* * * * * * * * *

(Tr. pp. 369-410.)

Charles E. Adams was called as a witness by the Petitioner, and was first duly sworn and testified as follows:

Direct examination.

By Mr. Wilson:

Q. Mr. Adams, what are your present positions with Air Reduction Company, Inc., and its four subsidiaries here involved?

A. I am chairman of Air Reduction Company, Inc., chairman of Air Reduction Sales Company, and chairman of the Board of the other companies involved.

Q. You are chairman of the Board, that is, of Air Reduction Sales Company, of Pure Carbonic, Inc., National Carbide Corporation and Wilson Welder and Metals Company; is that right?

A. I am chairman of Air Reduction Sales: The title is a little different.

Q. Would you mind explaining that to us?

A. Well, in 1936, I think it was, our then first vice president was taken ill. We wanted to change our official setup in order that he might not be charged with quite so much detailed responsibility as in the past. So the directors created a new office, that of Chairman of the company, i.e. Air Reduction Company, Inc., and that same title carried through into Air Reduction Sales.

[fol. 200] So that the man who had been first vice president then became assistant Chairman or Vice-Chairman of the company, and his duties as outlined in the by-laws were simply that he would take assignments and make reports as they were given him by the Chairman and he was relieved of his detailed responsibilities on account of his health, and I became the Chairman, and the Chairman, according to the by-laws of the company, was made the chief executive officer of the company.

Q. Over what period of years, Mr. Adams, has your connection with Air Reduction Company and these other companies extended?

A. I came with the company as treasurer on July 5, 1918.

Q. Will you tell us what official positions you occupied with Air Reduction Company and these four subsidiary companies throughout the year 1938?

A. I was Chairman of Air Reduction, Inc., Chairman of Air Reduction Sales, and Chairman of the Board of the others.

Q. In other words, your positions were the same throughout 1938 as they are now; am I correct in that?

A. Yes. They have been the same practically ever since 1936, when this change in official setup took place.

Q. Now, will you describe for us in your own way, Mr. Adams, how, in general, the management and direction of the affairs of Air Reduction Company, Inc., and its four subsidiaries was carried on in 1938 and at other times before and since?

A. Well, I came to the company, as I just said, in July, 1918. At that time I was told by the directors who offered me the position of treasurer that the great problem that Air Reduction faced was one of distribution. At that time the corporate setup included Air Reduction Sales Company as an operating company on the firing line. Air Reduction,

Inc., of course was in the position of parent company to Air Reduction Sales.

I soon discovered—and it didn't take much observation to discover it—that distribution was their big problem, the company's big problem. Here they were, in the oxygen business, and the acetylene business, primarily. In those two particular fields of activities, we were selling oxygen, we will say, of a value of $2, in a container that cost $18 [fol. 201] and weighed 150 pounds. Well, you can't distribute $2 worth of product very far in a container of that size and get it back again, and do anything but lose money.

So that it was evident at that early date that we were going to have a multiplicity of plants scattered all over the country. We never could possibly effect manufacturing economies by means of centralized manufacturing, that would offset the losses that we would suffer through distribution. Therefore, we planned, at a very early date, a wide, far-flung distribution of plants, which, of course, has come about. We have got 159 plants scattered all over the country.

That meant that we analyzed at that time the setup with regard to Air Reduction Sales. It was working and working very satisfactorily. We were going to have a central control, over a very far-flung series of plants all over the country. We needed a firing line management to operate Air Reduction Sales out on the firing line. We conceived of enterprises that impinged on the gas business, that is, the oxygen and acetylene business, that would be handled in the same way as Air Reduction Sales was then handled.

For instance, we could, even then—and I think it was as early as 1920 that we did—buy the National Carbide Company, which was a step towards integration. That was the raw material that we needed to make our acetylene gas. That had a little different firing line front than Air Reduction Sales, but the same method of handling it as had been tried out in Air Reduction Sales was obviously the way it was going to be handled. It worked. We had our central control in Air Reduction, Inc., and we had the firing line organization in National Carbide.

The same thing is true of Pure Carbonic, and the same thing is true of Wilson Welder. They were natural developments, handled in the same way.

Now, this central control was something that we wanted over this series of integrating units, for the reason that Air

Reduction, Inc., put up all the money. None of these subsidiaries ever put up a dollar. And handled all the money in so far as——

[fol. 202] Mr. Maddox: What was your statement: none of these subsidiaries what?

The Witness: Ever put up a nickel.

By Mr. Wilson:

Q. When you refer to these subsidiaries, will you just enumerate them, the ones that you refer to in that statement?

A. Air Reduction Sales. Then National Carbide came along. Then Pure Carbonic came along. Then Wilson Welder came along.

Q. Now, go right on from where you were. You said, I believe, that none of them had put up a nickel or some such——

A. None of them had put up any money at all. It was all Air Reduction, Inc.'s money. All the capital that has gone into the Air Reduction family of companies or group of companies, came from Air Reduction, Inc., either through the sale of stock, or at one time through the sale of convertible bonds which were turned into stock, or through the purchase of assets with cash.

Now, when we want to build a plant in "X" City in Michigan, the Air Reduction Sales Company, the Air Reduction Sales Board, does nothing whatever about that. The appropriation to build that plant comes to the Air Reduction, Inc.'s Board and is passed on. Then if a question of titles to real estate or anything of that sort is involved, the proper resolutions are formalized by a meeting of the Air Reduction Sales Company Board, just to keep our records in shape. Air Reduction Sales has absolutely nothing to say about whether they will build that plant or not, or where the money comes from. It all has to go to the central control. And that is true of all these other subsidiaries. They are in exactly the same position.

To the same degree, the general policy and decision on any important matter affecting any of these subsidiaries, necessarily has to come to the official heads of Air Reduction, Inc., where the question is decided—in all cases.

Q. And that is true of all matters of general policy, they are decided by the Board of Directors and the officers of Air Reduction Company, Inc.; is that right?

A. That is true and that has always been true.

[fol. 203] Q. Will you tell us the relationship between Airco and each of the subsidiaries throughout 1938 so far as it related to the matter of supplying of working capital? Who supplied that?

A. Air Reduction, Inc., supplied every cent.

Q. And has that been true not only through 1938 but in prior years, far back.

A. It has been true since July 5, 1918, I can assure you.

Q. And so far as the plant and fixed assets which is used by each of these subsidiaries in its operation, and was used during 1938, whose capital was invested in the plants so used by each subsidiary?

A. Air Reduction, Inc.'s capital in every case.

Q. And who supplied the initial working capital for the operations of each of these subsidiaries?

A. Air Reduction, Inc. If you want me to, I could elaborate a little further on the matter of this centralized organization.

Q. I would like you to explain as fully as you can the reasons and purposes and matters of business policy which, in your opinion, justified the so-called operating contracts which have been put in evidence here, and the operating agreements—operating arrangements which were made pursuant to them. If you have anything further to add, I would be very happy to have you do it, Mr. Adams.

A. Well, before I come to the answer to that specific question, I would like to point out——

Mr. Maddox: Now, I object to the voluntary statement of the witness. If the witness is to testify, I think I am entitled to have questions asked so that I have the opportunity to make the proper objections.

Mr. Wilson: Do you have some supplement to make to the answer that you were giving just a few moments ago, Mr. Adams?

A The Witness: I merely wanted to bring out the fact that in varying degrees these subsidiary companies can take advantage of centralized service staff functions, in Air Reduction, Inc., itself. To give an example, Pure Carbonic has to have a sales department of its own, because their products are sold to an entirely different trade. But Pure Carbonic, equally with Air Reduction Sales, can use the com-

[fol. 204] mon services of the purchasing department, the

traffic department, the statistical department, everything of that sort is common to them. In other words, in varying degrees these subsidiary companies are a complete body with both arms and both legs, but never a head, or a complete body, missing one arm, but never a head. Two things they never, any of them, had: they never had a head, never had a pocketbook. To varying degrees they could make use of these service departments of Air Reduction, Inc., which, of course, is an economical way of doing it rather than having independent purchasing departments, independent traffic departments, independent legal departments, independent everything else. That is, consolidated wherever it is practical in the central control.

Mr. Maddox: May I ask one question? You say never had a head and never had what else? A body?

The Witness: A pocketbook.

By Mr. Wilson:

Q. Was there anything further which you wish to add in response to my question, the substance of which was that I wished you to state the reasons and purposes and matters of business policy which, in your opinion, justified and made reasonable the operating contracts which have been put in evidence here, and the operating arrangements which were made pursuant to them? Have you any other facts along that line that you can add to your testimony?

A. Frankly, in 1918 and still, Air Reduction, Inc., was and is a New York corporation. Even at that early date it became evident, as I already said, we were going to have plants scattered all over the United States. We didn't want to domicile the parent company in 48 states of the Union and have us subject to service in all those states, that is, have the parent company subject to service in all those states, and that was distinctly a reason for using this corporate setup in connection with operations to be run as divisions, just as the contract sets forth.

Now, in addition to that, as a practical matter, out in the field and on the firing line, to have a representative, an officer, we will say, of Pure Carbonic, when trouble arises with a customer, a vice president of Pure Carbonic, who is not an officer of Air Reduction, Inc., at all, who goes in and [fol. 205] straightens that out with that customer, increases his endos, helps him with all his negotiating efforts, with their competitors on the outside:

Q. Now, Mr. Adams, was the matter of evasion or avoidance or reduction of payment of Federal taxes any part of the reasons or purposes which gave rise to the operating agreements here involved, and to the business arrangements which were made under them?

A. Well, I wasn't with the company when the 1917 contract with Air Reduction Sales was made, but since July 5, 1918, and in connection with the establishment of all the other subsidiaries, I never even heard the matter mentioned, and it certainly was never discussed or thought of.

Q. So that it was no part of such purpose or reason, so far as you yourself have any knowledge, either before you came with the company or after; is that right?

A. That is absolutely correct.

Q. That is all.

Cross-examination.

By Mr. Maddox:

Q. On July 5, 1918, when you became treasurer of the Air Reduction Company, what were your duties as treasurer, Mr. Adams?

A. My duties were to take care of the cash of the company, and, in general, to oversee the accounting records of the company. The auditor of the company reported to me.

Q. How long did you continue as treasurer?

A. My recollection is until January, 1920, when I became Executive Vice President.

Q. And as Executive Vice President in January of 1920, what were your duties?

A. The President of the company was absent nine-tenths of the time at that time, and I acted as president of the company and became President in January, 1921.

Q. I didn't get the date when you became President.

A. January, 1921.

Q. Who was President at the time you were Vice President?

A. A man named Blagden, Augustus S. Blagden. Did you say when I was treasurer or when I was vice president?

Q. No, when you were vice president.

[fol. 206] A. Blagden is right.

Q. Did you know Mr. Birge?

A. Yes, he was president when I was treasurer.

Q. Was he active head of the company at that time?

A. He was.

Q. Now, with reference to the 1917 contracts, they were in existence at the time you came with the company, were they not?

A. Yes.

Q. And that is also true of the Superior Companies, is it not?

A. The Superior Companies were already in, yes.

Q. And that is also true of the different companies organized in different states with the name of Air Reduction Company; isn't that true, such as Air Reduction Company of New Jersey, Ohio, Pennsylvania, and so on?

A. Yes.

Q. Did you ever examine the minutes of the corporation with reference to the contracts that were dated in 1917?

A. I don't know that I ever examined the minutes. I read the contracts.

Q. Have you read the minutes of the corporation?

A. I really can't tell you. It is a long time ago.

Q. Well, now, these Superior Companies, can you tell me how they were acquired? Do you know that?

A. Only by hearsay.

Q. Well, do you know it from the records of the company? You have examined records of the company at different times, have you not, as treasurer?

A. Well, I don't think I ever examined the records that had to do with the purchase of those companies. I knew what had gone on. But I don't think I ever examined the records.

Q. Well, now, you said, in your direct examination, how those companies were acquired, or, rather, you said they didn't put a nickel into the property that they possessed.

A. Yes.

Q. Now, I would like to know where you got that information, then.

A. Well, it was common knowledge that Air Reduction Company put up the money to buy the stock of the Superior [fol. 207] Companies. I have talked with any number of the officials of the Superior Companies who sold out to Air Reduction.

Q. As a matter of fact, Air Reduction Company went out and bought the stock of the Superior Companies, did it not?

A. That is correct.

Q. And all it held was the stock of those companies, did it not: Air Reduction Company?

A. To start with.

Q. And that continued until they were dissolved?

A. Yes.

Q. In 1934, '35, and '36; isn't that correct?

A. I don't remember when they were dissolved, I am sorry to say.

Q. Do you remember that they were dissolved?

A. Yes; I know they were dissolved.

Q. And do you remember that it was in the 1930's?

A. No; I wouldn't even remember that.

Q. You don't remember that?

A. They ceased to be operating units so early in the game that I never paid any more attention to them except as a name on the book.

Q. Well, it is established in the record that they were dissolved in 1934, '35, and '36, by other testimony.

A. Well, that is all right, then.

Q. And they continued as such. Now, they were operating companies, were they not? They had plants and they were manufacturing oxygen, and they were distributing the oxygen; isn't that true?

A. Well, at this date I would be very much surprised to learn that Air Reduction Sales didn't do all the billing, but I may be wrong.

Q. I didn't understand.

A. I would be very much surprised to learn that Air Reduction Sales didn't do all the billing as early as 1930, but I may be wrong.

Q. I am talking about the plants that Superior Companies owned: They owned plants, did they not?

[fol. 208] A. But they were being operated by Air Reduction Sales, according to my recollection. Now, I may be wrong.

Q. I am not speaking about the operation of the plants. They had plants and they were operated?

A. Yes, by Air Reduction Sales.

Q. I am asking you if the Superior Companies had plants and they were being operated; not by whom.

A. Oh, sure, certainly they were being operated.

Q. Yes. Now, that is also true of the Air Reduction Companies of the organization in the different states; isn't that true? Such as New Jersey, Ohio, Pennsylvania?

A. Yes.

Q. And each owned a plant or two?

A. That is right.

Q. And it was a substantial investment, was it not?

A. I don't know what you mean by "substantial." It was probably $150,000 or something like that, for the plants.

Q. Well, it was sufficient to take care of the cost of the plants, was it not, the investment?

A. I don't know what the capital setup was.

Q. You have no recollection of that?

A. No, it never was of any operating importance.

Q. Did Air Reduction Company own the stock of the Superior Companies?

A. Yes.

Q. Did they own the stock of the Air Reduction Companies organized in the different states?

A. Yes.

Q. Do you remember the amount of that stock?

A. No.

Q. You don't remember whether it was substantial or nominal?

A. Well, the Superior Companies' stock certainly represented whatever the capitalization was at the time Air Reduction, Inc., bought them.

Q. It was a fully capitalized company, was it not, each of those companies?

A. Yes, they must have been, because we bought the stock, we didn't buy the assets.

[fol. 209] Q. Isn't that also true of the Air Reduction Companies organized in the different states?

A. I really couldn't tell you because I never paid any attention to those companies.

Q. Now, Mr. Adams, did your position as treasurer in 1918, in scope, cover the distribution field of the company?

A. No.

Q. That was a matter of observation, then, when you were treasurer, as to the distribution problems?

A. It was one of the problems that the Board of Directors asked me to study, but it was not under my jurisdiction.

Q. Were you on the Board of Directors at that time?

A. No.

Q. Now, you say there are 159 plants. Do you mean 159 plants manufacturing gas?

A. No. 159 plants manufacturing the various products that we manufacture.

Q. Well, do you also include in the 159, warehouses?

A. No. No, we include laboratories.

Q. You include laboratories, but not storage facilities?

A. That is right.

Q. You say as early as 1920 Airco bought National Carbide?

A. That would be my recollection, that it was about 1920. I know it was before Blagden left. It might have been 1921.

Q. As a matter of fact, that was not a wholly-owned company at that time, was it? It was a matter of owning a percentage of the stock, wasn't it?

A. We first owned a percentage and then owned the whole business.

Q. But in 1920 you didn't own all of the stock of National Carbide, did you?

A. I don't remember. We completed the purchase, I would say, in 1921.

A. We first owned an interest, and gave them a contract to use their plants, and then we completed the purchase and turned it into a wholly-owned subsidiary. I don't know the exact date of that.

Q. That was not until 1926, was it not, that it became a wholly-owned company?

[fol. 210] A. We ran it from 1920 or 1921 on, as far as operating it was concerned. When we completed the purchase and made it a wholly-owned subsidiary, I don't know, I would have to refresh my memory as to that, it is a long time ago.

Q. Well, then, your statement, then, that as early as 1920 you bought National Carbide is not quite accurate, is it? You bought stock in the company, did you not?

A. We bought stock in the company.

Q. And it was part of the stock and not all of the stock?

A. We did take it in two bites, now that you speak of it. I had forgotten that we had taken it in two bites until you refreshed my memory.

Q. Do you recall who else was interested in National Carbide besides Air Reduction Company, who owned stock in it?

A. All the stock in the company was owned locally in and around New Field, West Virginia, and I went down there and negotiated for the purchase of the stock.

Petitioners' Exhibit 22.

ORGANIZATION AND FUNCTIONAL CHART OF AIR REDUCTION COMPANY, INCORPORATED

1938

STOCKHOLDERS OF AIR REDUCTION COMPANY, INCORPORATED

BOARD OF DIRECTORS OF AIR REDUCTION CO INC.

C. E. Adams — E. Deschere
A. R. Ludlow — R. B. Davidson
C. S. Munson — W. H. Hodge
C. E. Adams — F. E. Newbold
M. C. Brush — A. Rockefeller
Guy Cary — A. M. Scaife
R. K. Gossett — E. W. Stetson
W. M. Corse, Jr. — K. Wooley

BOARD OF DIRECTORS OF AIR REDUCTION SALES COMPANY

C. E. Adams — R. B. Davidson(1)
A. R. Ludlow
C. S. Munson
H. Van Fleet (1)

BOARD OF DIRECTORS OF PURE CARBONIC INCORPORATED

C. E. Adams — H. Van Fleet (1)
A. R. Ludlow — R. B. Davidson (1)
C. S. Munson — W. G. Oger, Jr.(1)
M. W. Rondel(1)(2)

BOARD OF DIRECTORS OF NATIONAL CARBIDE CORPORATION

C. E. Adams
A. R. Ludlow
W. C. Kavelry

BOARD OF DIRECTORS OF WILSON WELDER & METALS CO.INC.

C. E. Adams — H. Van Fleet (1)
A. R. Ludlow — W. C. Hodge
C. S. Munson — W. C. Kavelry (1)
T. B. Hosier

NOTES
(1) Vice President of Air Reduction Company, Incorporated
(2) Deceased 12-24-38

NOTES
(1) Vice President of Air Reduction Company, Incorporated
(2) Secretary of Air Reduction Company, Incorporated
(3) Deceased 12-24-38

C. E. ADAMS
Chairman — AIR REDUCTION CO., INC.
Chairman of Board — AIR REDUCTION SALES CO.
Chairman of Board — PURE CARBONIC, INC.
Chairman of Board — NATIONAL CARBIDE CORP.
Chairman of Board — WILSON WELDER & METALS CO., INC.

A. R. LUDLOW
Vice Chairman — AIR REDUCTION CO., INC.
Vice Chairman — AIR REDUCTION SALES CO.
President — PURE CARBONIC, INC.
Director — WILSON WELDER & METAL CO., INC.

C. S. MUNSON
President — AIR REDUCTION CO., INC.
President — AIR REDUCTION SALES CO.
President — NATIONAL CARBIDE CORP.
Director — PURE CARBONIC, INC.
Director — WILSON WELDER & METALS CO., INC.

Vice Chairman — AIR REDUCTION CO., INC.
Vice Chairman — AIR REDUCTION SALES CO.
President — PURE CARBONIC, INC.
Director — WILSON WELDER & METAL CO., INC.

C. S. MUNSON
President — AIR REDUCTION CO., INC.
President — AIR REDUCTION SALES CO.
President — NATIONAL CARBIDE CORP.
Director — PURE CARBONIC, INC.
Director — WILSON WELDER & METALS CO., INC.

Corporate

M. W. RANDALL
Vice President
Air Reduction Co., Inc.
Air Reduction Sales Co.
Pure Carbonic Inc.
Wilson Welder & Metals Co.Inc.

- **R. B. DAVIDSON** — Secretary — Air Reduction Co., Inc. / Air Reduction Sales Co. / Pure Carbonic Inc. / Wilson Welder & Metals Co.Inc.
  - C. E. SPENCE — Business Relations Manager — Distribution, Air Reduction Sales Co. For all Companies
  - T. C. HARRISON — Asst. Secretary — Legal Work and Patents For all Companies
  - E. W. HUMANN — Asst. Secretary — Patent Work, Trade Marks, Foreign Matters, Litigation For all Companies
  - J. J. THOMAS — Asst. Secretary — Assistant to Secretary For all Companies
  - W. M. DEER — U.S. Patent Agent — Patent Sales Air Reduction Sales Co. — U.S. PATENT OFFICE
- **E. C. TURNER** — Asst. Vice President — Air Reduction Co.Inc. / Air Reduction Sales Co.
  - J. E. FRICKER — Chief Engineer — Engineering Construction Manager For all Companies Engineering and Construction and Maintenance Work For all Companies
  - J. A. ALLEN — Asst. to V.P. — Special Assignments
  - JOHN MESSBOUGH — Manager — Special Plus Factory Cost Work, Factory Expense Control, Gases Sold Outside Organization
  - W. S. MOIR — Chief Inspector — Inspection Apparatus Sales Co. Control
  - J. J. CRONIN — Mgr. Apparatus Development — Research Control and Apparatus Development
  - J. L. ANDERSON — Manager — Welding and Cutting Apparatus Research — Maintenance Cutting Apparatus Development
- **H. VAN FLEET** — Vice President & Operating Manager — Air Reduction Co.Inc. / Air Reduction Sales Co. / Director of Pure Carbonic Inc. / Wilson Welder & Metals Co.Inc.
- **R. A. BISSONG** — Asst. Vice President — Air Reduction Co.Inc. / Air Reduction Sales Co. / Vice President Pure Carbonic Inc.
  - C. S. ANDREW — General Supt. Oxygen and Carbon Dioxide Plants — Oxygen, Nitrogen, Argon, Neon, Helium, Hydrogen, Carbon Dioxide Plants, Gases Sold in Cylinders
  - H. N. HILL — General Supt. Acetylene Plants — Acetylene Plants
  - C. A. MALLIN — Mgr. Acetylene-Cylinder Dry Plant — Acetylene Cylinder Dry Plant
- **C. M. BLOOMGOOD** — Pacific Coast Sales Manager
  - E. F. PETTIBONE — Vice Sales Manager — Gas Sales, Oxygen, Hydrogen, Nitrogen, Argon, Neon, Helium, Carbon Dioxide Plants, Gases Sold in Cylinders
  - H. L. ROGERS — Manager Welded Engineering — All Companies — Special and Field Welding Engineering — All Companies

Operations

Sales

G. D'W. GIBSON
Vice President
In Charge of Sales
Air Reduction Co., Inc.
Air Reduction Sales Co.

- **C. M. BLOOMGOOD** — Manager — Pacific Coast Sales Manager
  - E. F. PETTIBONE — Vice Sales Manager — Gas Sales - Oxygen, Hydrogen, Nitrogen, Argon, Neon, Helium, Carbon Dioxide Plants, Gases Sold in Cylinders
  - H. L. ROGERS — Manager Welded Engineering — All Companies — Special and Field Welding Engineering — All Companies
- **J. J. LINCOLN, Jr.** — Asst. General Sales Manager
  - C. S. ARMSTRONG — Railroad Sales — Railroad Sales
  - H. M. PEASE — Apparatus Sales — Apparatus Sales Oxygen Cutting Machines and Welding Equipment
  - C. M. SLOTTOW — Manager — Apparatus Sales — All Companies
  - Division Sales Managers — Division Sales Offices - Tonnage Sales, Gases Sold in Cylinders, Welding Equipment

Financial

W. C. KEELEY
Vice President
Air Reduction Co.Inc.
Air Reduction Sales Co.
Director
Pure Carbonic Corp.
Wilson Welder & Metals Co.Inc.

- **H. W. FRYER** — Treasurer — Air Reduction Co.Inc. / Air Reduction Sales Co. / Pure Carbonic Inc. / Wilson Welder & Metals Co.Inc.
  - F. R. VELIES — Asst. Treasurer — Pay Roll Section All Companies
  - H. W. DASSETT — Purchasing Agent — For All Companies
  - F. J. McCULLOUGH — Asst. Treasurer — Chief Auditor, For All Companies
  - J. C. BOWMAN — Asst. Treasurer — Special Assignments, Field Office Audits
  - New York Office Service — Office Service For All Companies
  - H. W. BARGES, Jr. — Credit Manager — Credit Supervision For All Companies
  - F. B. ADAMS, Jr. — Asst. Treasurer — Special Assignments, Field Office Audits For All Companies
  - W. A. BOWEN — Field Office Auditor — Field Office Audits For Plants
  - S. ALLEN — Manager Compressed Gases Sales Co. Plants — Cylinder Records, Sales Co. Plants
  - J. BONAFANT — Auditor — General Accounting For All Companies
  - E. C. ACKERMAN — Vice President — Carbide Sales, Carbide Chemicals, Trucks & Equipment For Materials Distribution Dept.
  - R. F. K. STOVELL — Operating Mgr. Carbide Plants — 2 Carbide Plants
  - T. S. YARLEY — Asst. Operating Mgr. Alloys Metals Dept. — Electric & Thermit Alloys Metals Plants
  - L. A. HULL — Asst. Vice President — Air Reduction Co.Inc. / Air Reduction Sales Co.
  - F. B. ADAMS, Jr. — Asst. Treasurer — Special Assignments, Field Office Audits For All Companies
  - W. A. BOWEN — Field Office Auditor — Field Office Audits For Plants
  - S. ALLEN — Manager Compressed Gases Sales Co. Plants — Cylinder Records, Sales Co. Plants
  - J. BONAFANT — Auditor — General Accounting For All Companies
  - E. C. ACKERMAN — Vice President — Carbide Sales, Carbide Chemicals, Trucks & Equipment For Materials Distribution Dept.
  - R. F. K. STOVELL — Operating Mgr. Carbide Plants — 2 Carbide Plants
  - T. S. YARLEY — Asst. Operating Mgr. Alloys Metals Dept. — Electric & Thermit Alloys Metals Plants

Financial

W. C. KEELEY
Vice President
Air Reduction Co.Inc.
Air Reduction Sales Co.
Director
Pure Carbonic Corp.
Wilson Welder & Metals Co.Inc.

- **L. A. HULL** — Asst. Vice President — Air Reduction Co.Inc. / Air Reduction Sales Co.
  - F. B. ADAMS, Jr. — Asst. Treasurer — Special Assignments, Field Office Audits For All Companies
  - W. A. BOWEN — Field Office Auditor — Field Office Audits For Plants
  - S. ALLEN — Manager Compressed Gases Sales Co. Plants — Cylinder Records, Sales Co. Plants
  - J. BONAFANT — Auditor — General Accounting For All Companies
  - E. C. ACKERMAN — Vice President — Carbide Sales, Carbide Chemicals, Trucks & Equipment For Materials Distribution Dept.
  - R. F. K. STOVELL — Operating Mgr. Carbide Plants — 2 Carbide Plants
  - T. S. YARLEY — Asst. Operating Mgr. Alloys Metals Dept. — Electric & Thermit Alloys Metals Plants

Distribution

E. E. HARDING
Vice President
Air Reduction Co.Inc.
Air Reduction Sales Co.
Pure Carbonic Inc.

- S. S. STRATTON — Asst. Distribution Manager — Distribution For all Companies
- C. C. MOLYNEUX — Purchasing Agent, Pacific Purchasing
- H. M. BAUSTIAN — General Traffic Manager — Traffic, Sales Co. Plants
- H. B. WELSH — Asst. Manager — Truck, Maintenance Sales Co. Plants

Research

F. J. METZGER
Vice President
In Charge of Research and Development
Air Reduction Co., Inc.
Air Reduction Sales Co.

- W. G. HUDSON — Research Engineer — Chemical Engineering For all Companies
- A. S. FINK — Chief Chemist — Chemical Research For all Companies
- J. H. BALLEW — Asst. Chief Chemist — Chemical Research For all Companies
- C. MC NUTT — Asst. Chief Chemist — Physical Research For all Companies

Q. Now, the stock that you purchased was in the National Carbide of Virginia, was it not?

A. I think it was incorporated in Virginia, yes, but the plant is in Virginia but the group——

Q. Yes.

A. But the group that controlled it came from New Field, West Virginia.

Q. And National Carbide of Virginia was not the operating company, was it?

A. I can't tell you that.

Q. Did you ever know that fact?

A. I no doubt did at the time, but at the present time I don't remember.

Q. It is just a matter of recollection? You don't recollect?

A. That is right.

Q. Now, it is also true with reference to Pure Carbonic of America that you originally only owned a percentage of the stock, isn't that true?

A. That is right.

Q. And who else was interested in that company?

A. Well, that——

Q. Industrial Alcohol, was it not?

[fol. 211] A. That goes back to the days of the Compressed Carbonic Company, in which company we had a 25 or 33 percent interest, I have forgotten which, and U. S. Industrial Alcohol Company had the rest. Then Compressed Carbonic lost its identity when we acquired a large interest in Pure Carbonic and Consolidated Compressed Carbonic with it. Pure Carbonic was a publicly-held company, largely held by Chicago and California capital. And we gradually acquired all the stock of Pure Carbonic.

Q. Do you recall when you acquired all the stock?

A. It must be in the records somewhere, but I would be guessing if I stated the year.

Q. And among the stockholders was Industrial Alcohol, was it not?

A. Yes.

Q. And they were a large stockholder of the company?

A. I wouldn't say large. What did they have, about—I would be guessing again. My recollection is about 12 percent.

Q. Do you recall any contracts Airco had with Industrial Alcohol with reference to the operation of the company?

A. We never had any contract with them for the operation

of Pure. We operated Compressed, which only had one plant to start with, and that was at the U. S. Industrial Alcohol plant in Baltimore.

Q. When you say no subsidiary ever put up a nickel, you mean by that that the funds the subsidiary got came from Airco, do you not?

A. That is right.

Q. In other words, Airco is the over-all company, and the company whose stock was used to raise funds; isn't that true, largely, in the general picture?

A. That is where all the capital came from except what was earned, it came from the sale of stock or other securities of Air Reduction, Inc.

Q. And that capital, in turn, was put in plants, was it not?

A. Yes.

Q. And equipment?

A. Plants and equipment.

Q. Necessary for business operation?

[fol. 212] A. That is right.

Q. Cylinders?

A. Yes.

Q. And those properties that were acquired by the cash were, in turn, turned over to the subsidiaries, isn't that true?

A. Not the cylinders.

Q. Not the cylinders, but the other property; is that true?

A. The other property.

Q. And then each subsidiary was supplied with working capital?

A. That is right.

Q. And that was initially, wasn't it?

A. Beg pardon?

Q. Initially?

A. Oh, yes.

Q. At the beginning?

A. Yes.

Q. Has it since been necessary to supply working capital to the subsidiaries?

A. Yes, because the credits of Air Reduction, Inc., on the books of these subsidiaries are such that they wouldn't have any working capital if they actually exchanged the cash with Air Reduction, Inc.

Q. We will get to that later. I am asking if there has been any interchange, if Air Reduction ever put funds into the

subsidiary companies since 1918, when you were with the company.

A. Well, yes.

Q. Working capital?

A. We have put it in and taken it out.

Q. Where did Air Reduction get that money with which that working capital, as you call it, was supplied to the subsidiaries, when those needs arose?

A. Out of their earnings, and out of their sale of securities. Nowhere else.

Q. It is a fact, is it not, that there has been very little need, if any, for working capital since the initial working capital was placed into those companies?

A. Well, we borrowed 25 million dollars last year.

[fol. 213] Q. Well, that doesn't answer my question. I said: has there been any need, or hasn't there been little, if any, need, for additional working captial other than the initial capital that was put in?

A. You mean on the part of the subsidiaries?

Q. Yes, for the subsidiaries' operations. Haven't their operations supplied the working captial?

A. Well, our earnings supplied—initial earnings supplied the working capital whenever it was needed. The companies operated under the terms of the contract, so that the earnings to a large extent came to Inc. Inc. never hesitated to furnish them with enough working capital out of its earnings.

Q. As a matter of fact, the policy has been to leave the earnings in the subsidiaries' treasuries or bank accounts or whatever you want to call them, to the extent that it was necessary to operate those subsidiary companies, has it not?

A. We take it out whenever Air Reduction, Inc., needs the money.

Q. Needs the money for what?

A. To make a payment of dividends. Any corporate enterprise. The building of a laboratory, or anything of that sort.

Q. And when they build a laboratory out of earnings, where do they put the laboratory?

A. The last one that we are building, we are putting over near Summit, New Jersey.

Q. I mean what company: Sales Company, Pure Carbonic, or what company?

A. It depends on the character of t' e laboratory. If it is this mechanical laboratory that we are building now, it would be an Air Reduction Sales enterprise.

Q. Now, you have mentioned the inter-company account through which the profits of the subsidiaries were drawn off to the Air Reduction Company, Inc. This inter-company account, through which the earnings of the subsidiary companies were drawn off to the Air Reduction Company, do you recall that account?

A. Well, I really don't examine those accounts personally. All I know is——

[fol. 214] Q. Well, aren't you familiar with the corporate setup of these companies?

A. Oh, yes.

Q. Well, wouldn't it be necessary in connection with the knowledge of that corporate setup to know those accounts?

A. No.

Q. It would not?

A. You mean in detail?

Q. Do you know what relationship they bear to the assets that appear on the balance sheets of the various subsidiaries?

A. Well, I have no doubt looked at that, but I couldn't tell you offhand what relation they have today, that is certain.

Q. Well, the evidence in the case indicates that the account bears a very close relationship to the total assets of the company.

A. Well, it naturally would.

Q. Yes. And that was built up on the books of the subsidiary by crediting the account payable account and on the books of the parent company by debiting the account receivable account to the extent of the cost of plants put into the company, plus earnings?

A. Right. The books are operated exactly in accordance with the contract.

Q. Now, I am asking you: how did you expect those accounts payable to be paid?

A. Well, either we get back the property or we get the money, if we ever came to a liquidation.

Q. And why would you get the property?

A. Because they owed us the money, if we liquidated.

Q. There was no intention, was there, to ever have that account payable paid in cash?

A. Whenever we needed the cash, if they had the cash, yes.

Q. But suppose they didn't have the cash, how could you collect, then?

A. Then we couldn't get it, obviously.

Q. In other words, there would be a liquidation of the company and you would have to take the assets in liquidation?

A. Well, I don't know. The question has never arisen certainly as far as we are concerned.

[fol. 215] Q. Well, I am asking you: was there ever any intention that that account be paid?

A. The question has never arisen.

Q. I am asking you: was there ever any intention? The question is arising now.

A. I never heard it discussed.

Q. As a matter of fact, that account could not be paid in cash, could it?

A. I am not familiar with the details of those accounts, but I would be very much surprised if it could.

Q. I am not talking about the details of the account. I am talking about the account itself, just as a general proposition.

A. Well, the records speak for themselves. I can't answer you.

Q. You prefer not to make a statement?

A. I can't answer it. I am not familiar with the records.

Q. Now, did you ever make any demand on the subsidiaries for payment of that account?

A. No; we just took it away from them under the terms of the contract, if we needed the money.

Q. To the extent of what, you took it away from them?

A. To the extent of initial contractual rights.

Q. Only to the extent that there was accumulated earnings in that account; isn't that correct?

A. Sure, because all we wanted was cash.

Q. That is all you could take, wasn't it?

A. That is all we wanted, was cash.

Q. Did those accounts bear interest?

A. I think not.

Q. Were there ever any notes issued to cover them?

A. I can't tell you that, either.

Q. Was the New York company engaged in loaning money?

A. Air Reduction, Inc.?

Q. Yes; Air Reduction, Inc. Was it in the loan business?

A. No. It has loaned money, of course.

Q. Did you ever demand security for those accounts, accounts payable, on the books of the subsidiary and accounts receivable on the books of the parent?

A. No.

[fol. 216] Q. Now, going back to the proposition as to whether the Air Reduction Companies of the different states were nominally or substantially capitalized, I refer you to the 1933 return of Air Reduction Company, Inc., and subsidiaries, to refresh your recollection on that, and I ask you if you can now answer the question. I refer you principally to what is headed "General Balance Sheets as Adjusted December 31, 1932, and Consolidated," and ask you, from an examination of that, if you can answer that question now.

A. What was the question, please?

Q. As to whether the Air Reduction Companies of the different states, such as New Jersey, Virginia, Pennsylvania, and so forth, were substantially capitalized.

A. Obviously, they show total fixed assets.

Q. Well, here is your capitalization.

A. Well, Minnesota had a capitalization of $300,000.

The Court. Just give the amount, if you have it there.

Mr. Wilson. Your Honor, may I know what paper that is that Mr. Maddox has just handed the witness?

Mr. Maddox. I stated it in my question. It is the consolidated return of December 31, 1932.

Mr. Wilson. I beg your pardon.

A. The amounts are shown here.

The Court. You might read the amounts.

The Witness. Virginia, $19,000, very insubstantial; Minnesota——

The Court. You don't need to give your opinion as to whether they were substantial or not. That will be a question, I suppose, if it is material, for the Court to determine, but just read, if there are any of them there, the company name and the amount of its capitalization, as shown on the return.

The Witness. California, $100,000; Massachusetts, $25,000; Michigan, $100,000; New Jersey, $150,000; Virginia, $19,000; Minnesota, $300,000; Ohio, $100,000; Illinois, $300,000.

By Mr. Maddox:

Q. Now, did those companies have a surplus?

A. Yes, they had a profit and loss surplus combined of $14,000 in California; $3,600 in Massachusetts; $14,000 in [fol. 217] Michigan; $21,000 in Jersey; $2,700 in Virginia; $43,000 in Minnesota; $14,000 in Ohio; $150,000 in Illinois.

Q. Now, wasn't the corporate setup, as it existed between 1917 and 1934, or thereabouts, when the Superior and Air Reduction Companies of the States were dissolved, substantially different than it was thereafter?

A. No. Possibly somewhat in form, but in substance absolutely no different.

Q. Well, is the difference in this respect: that instead of the various assets being held by the Superior Companies and the Air Reduction Companies of the different states, they were then held by Air Reduction Sales Company? Isn't that true?

A. That is absolutely true. Air Reduction Sales operated them all during the period that you asked me about. Air Reduction Sales operated them all.

Q. Operated them for whom?

A. For those companies, and through those companies into Air Reduction Company, Inc. Everything poured right through those companies into Inc.

Mr. Wilson: Mr. Maddox, may I suggest that you let the witness complete his answer, please? I think you are interrupting a little bit.

A. Those State Companies just acted as funnels, and a little something—I have forgotten how much—stuck to the funnel as it came through into Inc.

By Mr. Maddox:

Q. When you say "the other companies," you mean the other subsidiary companies that you have just mentioned, the Superior Company and the Ohio Air Reduction Companies?

A. Yes, obviously those companies were already getting clumsy, we were getting too many of them.

Q. In other words, Air Reduction, after dissolution took place; is that it?

A. Well, they just disappeared out of the picture.

Q. Well, they were dissolved?

A. We had a direct connection instead of a connection through a funnel. That is about the whole size of it: in substance, there was no difference.

[fol. 218] Q. As a matter of fact, those companies were dissolved, were they not?

A. I don't remember when, but I know they have been dissolved.

Q. I am not asking you when. I said they were dissolved.

A. I know they have been dissolved.

Q. And their assets were distributed to whom?

A. The physical assets?

Q. Yes.

A. Air Reduction Sales.

Q. Now, what happened to the contracts that had existed between Air Reduction Sales and the other subsidiary companies, the ones that were dissolved?

A. Well, when the companies dissolved, then, the Air Reduction Sales Company, then in existence, that contract with Air Reduction, Inc., was simply blanketed to cover the new assets which they acquired title to. Of course, the contract disappeared.

Q. Now, I understood you to say that the purpose of the subsidiaries was to insulate the Airco New York corporation from becoming domiciled in other states; is that the statement?

A. That was one reason, without doubt.

Q. Was there any other reason for the existence of the subsidiaries?

A. Well, the one that I gave as another reason was that it strengthened the hand of the men on the firing line in these subsidiary companies.

Q. Have you seen the organizational chart?

A. Yes, indeed.

Q. Which is in evidence here?

A. Yes.

Q. What was the purpose of having Boards of Directors of the various subsidiary companies?

A. Because the subsidiary companies had in many cases to formalize action that had been approved by the Air Reduction, Inc., Board, for legal purposes.

Q. Why was there a variance between the Boards of Directors? Do you recall what they are without the chart? Do you have the chart?

A. I have the chart right here. There naturally would

[fol. 219] be a variance because in, we will say, the case of Pure Carbonic, for example, there was a different group actually operating that company than was the case in Air Reduction Sales.

Q. Well, let's take that group, for Pure Carbonic. C. E. Adams. It appears there. That is yourself?

A. Yes, that is right.

Q. And you originally came into this group of companies that existed in 1930 through Air Reduction; isn't that right?

A. I originally came in in 1918.

Q. Into Air Reduction.

A. Yes.

Q. Now, Mr. Ludlow, he didn't, did he? He came in through Pure Carbonic, didn't he?

A. No, he came in through Air Reduction, entirely.

Q. Well, was he not an officer of Pure Carbonic?

A. He was an officer of Pure Carbonic, but——

Q. A partial stockholder?

A. I got Mr. Ludlow in 1918 and 1919 to come in as Sales Vice President of Air Reduction, Inc.

Q. How about Mr. Munson?

A. Mr. Munson came in—let's see, I would say about—and I am guessing now—1924.

Q. Well, I don't want a guess, if you can't give me a substantial answer.

A. Well, I can't give it too accurately, but it is somewhere in the twenties.

Q. Where did he come from?

A. We had a partially-owned company in Cuba, and he was treasurer of the Cuban Air Products Company. We acquired all of the Cuban Air Products Company and he came in to Air Reduction Company, Inc., and has been there ever since. That was, I would say, in the early twenties.

Q. Hasn't he been much with the Carbide Company?

A. He was made president of the Carbide Company when we finally acquired all the stock.

Q. Now, in the Wilson Welder block: Mr. Hasler.

A. Yes.

Q. Where did he come from?

A. He came from the Wilson Welder and Metals Company and was there when we acquired it.

[fol. 220] Q. How about F. E. Hasler?

A. That is his brother, and he is a banker and is on that Board of Directors as a complimentary member of the

Board simply because he was on the old Board of Wilson Welder when we acquired their assets. No, I guess we acquired the stock of Wilson Welder.

Q. Beg pardon?

A. I guess we acquired the stock of Wilson Welder, didn't we?

Q. That is my understanding, that you acquired the stock, part of it originally, and then eventually the balance.

A. Yes, the way we did with National Carbide.

Q. The manufacture of oxygen and the gases that are handled by Air Reduction Sales Company presents considerably different problems than the gas manufactured by Pure Carbonic, I understand your direct examination to be.

A. Yes.

Q. Isn't that true?

A. Well, the sales—the distribution problem is almost identical.

Q. I am talking about the over-all picture, though, from the beginning to the end, the manufacturing, the sale, and distribution.

A. Manufacture and sale are quite different.

Q. Now, that is also true of the National Carbide Corporation, isn't it?

A. The manufacture is quite different, the sales are closely affiliated in that they go to the same field that is covered by Air Reduction Sales, but the production is quite a different problem, and the distribution is quite a different problem.

Q. And that is also true of Wilson Welder and Metals Company, is it not?

A. More or less in the same class as National Carbide. The manufacturing problem, the production problem is different, the products produced go to the same trade as Air Reduction Sales Company's customers. The distribution problem is quite different.

Q. I don't understand your answer there.

A. Well, the metal working trades of the country use the products of Wilson Welder just as they use the products of Air Reduction Sales. That isn't true of Pure Carbonic at all. It is true of National Carbide.

[fol. 221] Q. Similarity?

A. The production of all three subsidiaries are different from the production problems of Air Reduction Sales.

That was what I tried to cover in a broad way in my direct testimony.

Q. Now, these Boards of Directors of the various subsidiary companies: they function, do they not? They are not just window-dressing, are they?

A. Well, they meet once a year for purposes of organization, and they meet whenever they are called to take formal action throughout the year, if we need the authorization to sign a deed for the transfer of real estate or something like that, and that is the only times they ever meet.

Q. Is the Board of Directors of Air Reduction Company of substance, too?

A. Air Reduction, Inc.?

Q. Yes.

A. It is, indeed. It meets once a month as a Board, and once a month through its Executive Committee.

Q. Now, you have the chart before you there?

A. Yes.

Q. You are designated as Chairman, and Chairman of the Board of the various companies, and then under your name appears Mr. Ludlow as vice Chairman of the two of the companies and president of Pure Carbonic and a director of Wilson Welder. And then underneath Mr. Ludlow is Mr. Munson. Now, I assume that in the order given there, the three officers, yourself, Mr. Ludlow, and Mr. Munson, function in those capacities in the absence, or in between the meetings of the Boards of Directors?

A. Yes.

Q. That is the purpose of it, isn't it?

A. They are in charge of the management, or the administration of the management.

Q. In other words, the Board of Directors function in a normal corporate way, do they not?

A. Absolutely.

Q. And then the Chairman and Vice-Chairman, the President and the officers of the corporation function in the normal corporate way?

[fol. 222] A. Yes, sir.

Redirect examination.

By Mr. Wilson:

Q. Mr. Adams, I have just one question. I show you the following exhibits:

Petitioner's Exhibit 2, which is a photostatic copy of the operating agreement between Air Reduction Co. and Air Reduction Sales Company; Petitioner's Exhibit 6, which is a photostatic copy of the operating agreement dated Aug. 25th, 1922, between National Carbide Corporation and National Carbide Sales Corporation; Petitioner's Exhibit 8, which is a photostatic copy of a supplementary agency agreement dated August 1, 1936, between Air Reduction Co., Inc., and National Carbide Corporation; Petitioner's Exhibit 9, which is a photostatic copy of an agreement dated October 1, 1929, between Pure Carbonic Company of America and Pure Carbonic, Inc.; and Petitioner's Exhibit 16, which is a copy of the operating agreement dated August 1, 1936, between Air Reduction Company, Inc., and Wilson Welder & Metals Company.

I will ask you to look at those exhibits and tell us whether or not each of those respective agreements was in full force and effect from their respective inception dates, throughout the year 1938, and to date?

A. Yes, these are the ones we operated under.

Q. And they were in full force and effect during the period I have indicated, from their respective inceptions, through 1938, and to date, is that right?

A. That is correct.

Mr. Wilson: That is all. I have no further questions.

Recross-examination.

By Mr. Maddox:

Q. Now in all of these contracts, Mr. Adams, there is a provision that the subsidiary company is to retain 6% on its outstanding capital stock. Do you recall that?

A. Yes.

Q. Do you know how the 6% was fixed?

A. Right out of the air, I think. It is just a common figure of return on an investment.

Q. Are you acquainted with Petitioner's Exhibit 3, the agreement between Air Reduction Sales Company and Air

[fol. 223] Reduction Company of New Jersey, dated March 1, 1917? That was one of the subsidiaries that was dissolved in 1934, 1935 or 1936?

A. Yes.

Q. And the Sales Company, of course, is the present Company?

A. Yes.

Q. Are you familiar with that contract?

A. Yes.

Q. Do you know how the 12½% figure stated in subparagraph 8 of Article III was fixed?

A. Frankly, I have often wondered. I don't know.

Q. You have no explanation?

A. Well I imagine it was because they were really holding title to that property.

Q. After you came with the Company, when new companies were organised, similar to this one, after you got there, was there any discussion as to the 12½%?

A. They were modeled after that. They held title to the property, is the only explanation I can think of.

Mr. Maddox: That is all.

Mr. Wilson: I have nothing further.

The Court: You are excused.

(witness excused.)

Mr. Wilson: The three Petitioners rest, your Honor.

The Court: Very well.

* * * * * * *

(Tr. 413-414.)

Mr. Maddox: I think I can dispose of it very readily. At this time I offer in evidence the 1938 Corporation Income and Excess Profits Tax Return of National Carbide Corporation.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit A.

(The National Carbide Corporation Income & Excess Profits Tax Return for 1938 was marked Respondent's Exhibit A and received in evidence.)

Mr. Maddox: I offer the Corporation Income and Excess Profits Tax Return of Pure Carbonic, Inc., for the year 1938.
[fol. 224] Mr. Wilson: No objection.
The Court: It will be received in evidence as Respondent's Exhibit B.

(The Pure Carbonic, Inc., Corporation Income & Excess Profits Tax Return for 1938 was marked Respondent's Exhibit B and received in evidence.)

Mr. Maddox: I offer in evidence Corporation Income and Excess Profits Tax Return of Air Reduction Sales Company for the year 1938.
Mr. Wilson: No objection.
The Court: It will be received as Respondent's Exhibit C.

(The Air Reduction Sales Company Corporation Income & Excess Profits Tax Return for 1938 was marked Respondent's Exhibit C and was received in evidence.)

Mr. Maddox: Now these are returns taken from the Respondent's files, and I ask the privilege of withdrawing them and substituting photostatic copies.
The Court: That permission is granted.
Mr. Maddox: I will call Mr. Charles E. Adams to the stand.

(Tr. 414-417.)

CHARLES E. ADAMS, a witness on behalf of the Respondent, was duly sworn and testified as follows:

Direct examination.

By Mr. Maddox:

Q. I ask you, Mr. Adams, if you can identify this document which I have placed before you.
A. Yes, I can. I can identify my signature, and recollect the document as such.
Q. What is the paper?
A. Corporation Income and Excess Profits Tax Return.
Q. For what year?
A. For the calendar year 1919.
Q. Now, directing your attention to certain schedules,

in this instance designated Question 1, Table 8, and directing your attention to the second page of Table 8, and in particular to item 27, read item 27.

A. "Is any property owned by one Company used by another?"

Q. Now what is the answer to that, under "Air Reduction Company"?

A. "Yes, by No. 2."

[fol. 225] Q. And "No. 2" is what?

A. "Air Reduction Sales Company."

Q. What is the next question?

A. "What charge is made for its use?"

Q. Now what is the answer?

A. "None."

Q. And coming over into column 3, which is headed what?

A. "California".

Q. And what above that?

A. Column 4 is Air Reduction Company of Michigan, column 5 is New Jersey, column 6 is Virginia, column 7 is Minnesota.

Q. But the full title is "Air Reduction Company of California", is it not?

A. Yes.

Q. Coming under column 3, what is the answer to the question No. 28 there: "What charge is made for its use?".

A. "12½% on invested capital."

Q. Now directing your attention to the next question.

A. "Does this represent a fair return? If not, what is a fair return?".

Q. And under column 3, what appears?

A. "No."

Q. The next question?

A. "Are there any other arrangements between the companies which might effect an artificial distribution of profits?"

Q. No, what is the next question?

A. I read that before: "If not, what is a fair return?"

Q. Did you read that?

A. Yes.

Q. What is the answer?

A. "No."

Q. You are getting ahead, there.

A. I see. "20%".

Q. Now the answers to those questions are to the effect

that 12½% mentioned in the contract is not a fair return. Isn't that correct?

A. That is what it says. I am not familiar with this detailed schedule at all.

Q. You signed this return, did you not?

A. I signed the return, but I am not familiar with the detailed schedule.

[fol. 226] Q. Now following those questions over, and the answers that are given with reference to each company, what appears there?

A. "See No. 3," "See No. 3," and so forth.

Q. In other words, the answers to the questions under column 3 apply to columns 4, 5, 6, 7, 8, 9, 10, 11, all the way across? All the way through column 16?

A. Yes.

Q. And those numbers designate the various subsidiaries we have referred to as Superior companies and Air Reduction Companies of the various States?

A. Yes.

. . . . . .

(Tr. 418-430.)

THOMAS G. HARRISON a witness on behalf of the Respondent, was duly sworn and testified as follows:

Direct examination.

By Mr. Maddox:

Q. Are you an officer of the Air Reduction Company?

A. Yes, sir, Assistant Secretary.

Q. Are you also an officer of the various subsidiary companies? The Air Reduction Sales Company?

A. Yes.

Q. And Pure Carbonic?

A. Yes.

Q. And National Carbide?

A. Yes.

Q. Have you produced here the minutes of the Board of Directors meeting authorizing the execution of the agreement dated March 1, 1917, between Air Reduction Company and Air Reduction Sales Company?

A. I produced certain minutes. I don't believe there is a set of minutes for that particular subsidiary.

Q. Did you make a search for that minute?

A. I made a search for them and could not find them.

Q. You could not find them?

A. No.

Q. How long have you been with the companies, Mr. Harrison?

A. 27 years.

Q. Beginning with what time?

[fol. 227] A. October 1, 1918.

* * * * * * * *

Q. Now, Mr. Harrison, do you have the minutes of the Board of Directors meeting of Pure Carbonic of America authorizing the execution of the agreement of October 1, 1929? Between Pure Carbonic of America and——

A. Yes, minutes of April 24, 1930.

Mr. Maddox: I offer this in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit D.

(The minutes were marked Respondent's Exhibit D and were received in evidence.)

By Mr. Maddox:

Q. Do you have the minutes of the Board of Directors meeting authorizing the execution of the agreement of August 25, 1922, between National Carbide Corporation, the Virginia Corporation, and National Carbide Sales Corporation, the Delaware Corporation?

A. I have minutes here of August 10, 1922, of National Carbide Corporation authorizing the execution of such an agreement but no date is mentioned of the agreement.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit E.

(The minutes were marked Respondent's Exhibit E and were received in evidence.)

By Mr. Maddox:

Q. Now, do you have the minutes of the Board of Directors meeting of Air Reduction Sales Company authorizing

the execution of agreements of March 1, 1917, between the Sales Company and the Air Reduction Company?

A. No, sir.

Q. You have no minutes for that?

A. I have minutes here of February 21, 1918, which stipulates that they have entere into the following contracts, one of which is the management and sales contract between Sales Company and Air Reduction Company, Inc.

Q. That is one of them. Are there any others?

[fol. 228] A. Yes——

Q Now, may I see the minute, please?

A. Yes, sir.

Q. This minute covers, in addition, other contracts, does it?

A. Yes, sir.

Q. Besides the one I asked about?

A. Yes, sir.

Q. Will you state what those are, briefly?

A. Management and sales contracts dated March 1, 1917, between Air Reduction Sales Company and Air Reduction Company of California, Air Reduction Company of Michigan, Air Reduction Company of New Jersey, the Ohio Air Reduction Company, Minnesota Air Reduction Company, Superior Oxygen Company of New York, Inc., Superior Oxygen Company of Pennsylvania, Superior Oxygen Company of Ohio, Superior Oxygen Company of Illinois, and Superior Oxygen Company of Missouri.

Supplementary agreement May 15, 1914, between Air Reduction Sales Company and Superior Oxygen Company of Missouri? Also Niagara Oxygen Corporation, Niagara Oxygen Company, Inc., Searchlight Company of Illinois.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit F.

(The minutes were marked Respondent's Exhibit F and received in evidence.)

By Mr. Maddox:

Q. Now, do you have a minute authorizing the agreement of March 15, 1919, between Air Reduction Sales Company and Air Reduction Company of Virginia?

A. Yes, sir, the minutes of the meeting of August 6, 1919.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court. It will be received in evidence as Respondent's Exhibit G.

(The minutes were marked Respondent's Exhibit G and received in evidence.)

Mr. Maddox: I might also state that this covers the contract of the Air Reduction Company of Massachusetts.

[fol. 229] By Mr. Maddox:

Q. Now, do you have minutes covering the authorization for the contract of December 31, 1921, between Air Reduction Sales and Superior Oxygen of New York, Inc.?

A. Yes, sir; minutes of meeting of December 31, 1921.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit H.

(The minutes were marked Respondent's Exhibit H and received in evidence.)

By Mr. Maddox:

Q. Now, do you have the minutes of the Board of Directors meeting of National Carbide Corporation, which was formerly National Carbide Sales Corporation, authorizing the agreement of August 25, 1922, between National Carbide Corporation, the Virginia corporation, and National Carbide Sale Corporation, the Delaware corporation?

A. I have minutes of a meeting of August 15, 1922, authorizing the execution of an agreement dated August 15, 1922, between National Carbide Corporation and National Carbide Sales Corporation, instead of August 25.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit I.

(The minutes were marked Respondent's Exhibit I and received in evidence.)

By Mr. Maddox:

Q. Now, do you have the minutes of the Board of Directors meeting of the same corporation, that is, the National Carbide Sales Corporation, the Delaware corporation, authorizing the execution of an agreement of August 1, 1936, between Air Reduction Company and National Carbide Company, formerly the Sales Company?

A. I don't have any such minutes here.

Q. Did you make a search for that?

A. Do you mind if I look at my records?

Q. Certainly not.

[fol. 230] A. As I understand your question, this is the National Carbide Corporation, formerly National Carbide Sales Corporation.

Q. That is true.

A. Of the execution of an agency agreement of August 25, 1922, between National Carbide——

Q. No, August 1, 1936, between Air Reduction and National Carbide Corporation, formerly the Sales Company.

A. No, I do not find any minutes on that.

Q. Did you make a search?

A. Yes, sir.

Q. Do you have the minutes of the Board of Directors meeting of Pure Carbonic, Inc., authorizing the execution of an agreement of October 1, 1929, with Pure Carbonic of America, a Delaware corporation?

A. Yes, sir, I have minutes here of a meeting of April 10, 1930, authorizing the execution of an agreement between Pure Carbonic and Pure Carbonic of America.

Mr. Maddox: I offer that in evidence.

Mr. Wilson: No objection.

The Court: It will be received in evidence as Respondent's Exhibit J.

(The minutes were marked Respondent's Exhibit J and received in evidence.)

By Mr. Maddox:

Q. Do you have the minutes of a Board of Directors meeting of Wilson Welder and Metals, Inc., authorizing the reduction in the valuation of capital stock during the year 1934?

A. Yes, sir, I have minutes here of a meeting of February 13, 1934.

Mr. Wilson: Mr. Maddox, may I make this statement for the record? I think it may clarify a very slight matter. We have produced here, pursuant to your subpoena, various excerpts from the minutes which you have been designating. So that the minutes described as the minutes of the Board of a particular date are not the entire minutes in every case, simply the requested excerpt. Otherwise the large gaps might look strange to someone who wasn't acquainted with that.

The Court: Very well.

Mr. Maddox: I am not over this one.

[fol. 231] By Mr. Maddox:

Q. Do you have here, Mr. Harrison, the other items requested in the subpoena, such as the insurance policies, tax bills?

. . . . . .

(Tr. 430-432.)

Bruno J. Eichert, a witness called by the Respondent was first duly sworn and testified as follows:

Direct examination.

By Mr. Maddox:

Q. Mr. Eichert, are you responding here with reference to subpoenas served on the Air Reduction Company, Air Reduction Sales Company, and other related companies?

A. Yes, sir; I am.

Q. And in what respect are you responding, what portion of the subpoena?

A. The insurance policies.

Q. Do you have those here?

A. They are here in the court.

Q. Would you produce them, please?

A. Yes, sir.

Q. Are these the policies of insurance of the Air Reduction Sales Company? The ones called for in the subpoena, Air Reduction Sales Company?

A. They are the policies of insurance of Air Reduction Sales Company and other companies.

Q. Let me have those pertaining to the Sales Company.

A. The policies are blanket policies so they don't cover one company only.

Q. They cover all companies?

A. Yes.

Q. May I see one?

A. Yes, sir.

. . . . . .

Q. As I understand your statement, Mr. Eichert, these policies cover all of the companies?

A. That is correct.

Q. And these were all of the policies that were in effect during the year 1938?

A. Most all the policies, Mr. Maddox. There were a few that couldn't be located.

Q. There were a few that couldn't be located?

[fol. 232] A. Yes.

Q. And these policies are the ones that account for the deduction on the 1938 returns, or do you have any knowledge of that fact?

A. I didn't attempt to go that far. I did tie the policies in with the books of account, but I didn't check through to the income tax returns.

. . . . . .

(Tr. 433-436.)

ALLAN S. PAYNE, a witness called by the Respondent was first duly sworn and testified as follows:

Direct examination.

By Mr. Maddox:

Q. Now, Mr. Payne, you are responding with reference to the subpoena on Air Reduction Sales Company, calling for the tax bills of that company, supporting the deduction of 536 thousand-odd dollars?

A. Yes.

Q. Do you have those bills?

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A. I have a substantial portion of the bills right here.

Q. And what do they cover, principally? What type of property? What type of tax?

A. Well——

Q. Just in a general sort of way, not detailed.

A. I have not examined these, but from my general understanding, I believe they cover personal property taxes.

Q. Such as machinery and equipment and things of that nature, you mean?

A. That is right.

Q. Do they cover real property taxes, too?

A. Yes, I believe they do.

Q. May I examine those?

A. Yes.

Q. What are these?

A. Air Reduction Sales Company for the month of January.

Q. Did you handle the tax matters of the companies? Air Reduction Companies?

A. No.

Q. Were you engaged in that in any way?

A. In handling the tax matters.

Q. Yes, in connection with these tax bills.

[fol. 233] A. I was responsible for the drawing of the voucher, for the payment of the tax.

Q. Did you state that from examination of these bills that they covered personal property taxes and also real property taxes of Air Reduction Sales Company?

A. Well, I have not examined these.

Q. Well, would you examine them, so that you can respond to that question?

A. Yes.

Q. Examine a sufficient number of them.

A. Yes, sir.

(Witness does as requested.)

By Mr. Maddox:

Q. Now, can you state what type of tax is covered by these bills?

A. These bills which I have just examined cover the franchise taxes, County taxes, personal property taxes, real estate taxes, license fees.

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Q. Do you have similar tax bills for Pure Carbonic, Inc.?

A. I have the bills here. Would you like me to look at them to determine——

Q. Do you have those?

A. Yes.

Q. And do you also have bills for National Carbide Corporation?

A. Yes.

Q. Would you examine those sufficiently to answer a question with reference to the type of taxes they cover?

A. Yes, sir.

(Witness does as requested.)

A. The tax bills that I have examined of the other companies appear to cover the same type of taxes as in the case of Air Reduction Sales Company.

Mr. Maddox: I have no further questions.

Mr. Wilson: No questions.

Mr. Maddox: Now, Mr. Payne, are you responding on the question of the lease, Air Reduction Sales Company's lease?

Mr. Payne: No, sir.

. . . . . .

(Tr. 436-446.)

[fol. 234] THOMAS G. HARRISON, having been heretofore duly sworn, resumed the stand and testified further as follows:

Direct examination (cont'd).

By Mr. Maddox:

Q. Do you have the leases referred to in the subpoena, Mr. Harrison, shown on the profit and loss statement of Air Reduction Sales Company for 1938 in the sum of some $186,000?

A. I have here all of the leases which were in effect during the year 1938, on Air Reduction Sales Company, Pure Carbonic, National Carbide.

Q. Well, I am interested principally in the Sales Company's leases right now.

MATTHEW BENDER & COMPANY MB

A. All right. I have all of the leases which were in effect during the year 1938 on Air Reduction Sales Company.

Q. Have you made an examination of those in connection with answering the subpoena?

A. No; I have just drawn these leases from our contract files.

Q. I see. Is this all of the leases?

A. This is all of the leases that were in effect during the year 1938.

Q. Can you tell without examining those leases what they cover?

A. They cover the lease of properties, warehouses, plants.

Q. Do they cover the——

A. Offices.

Q. That is throughout the United States?

A. That is true.

Q. And do they cover any property here in New York? New York City, that is.

A. Yes.

Q. What property?

A. The Lincoln Building, 60 East 42nd Street, and some other property.

Q. Are there any other properties that you recall other than those you have mentioned?

A. Yes, there is our old record room down Broadway.

Q. Will the same statement hold for Pure Carbonic?

A. Yes, sir. I have the leases here that were in effect in 1938 for Pure Carbonic.

Q. And it would cover substantially the same type of property?

[fol. 235] A. Yes.

Q. And is that also in the similar situation with reference to National Carbide Corporation?

A. That is true.

Q. Were there any others that you mentioned? You have four folders.

A. Well, there are two folders on the Sales Company here, and this one contains Pure Carbonic and National Carbide, and this one contains Pure and National.

Q. That covers all of those companies?

A. All of the companies.

Mr. Maddox: I have no further questions.

Mr. Wilson: No questions.

The Court: You are excused.

(Witness excused.)

Mr. Maddox: Respondent rests.

Mr. Wilson: May I have just a moment, your Honor?

The Court: Yes.

Mr. Wilson: I would like to call upon Mr. Maddox to produce, pursuant to request, certain income and excess profits tax returns. The first one is the Consolidated income tax and profits tax return for 1919, of Airco.

Mr. Maddox: If you tell me which ones you want, I will get them. They are in the next room, and I will have to go in there and get them. I took them out of the court room because I thought you were through.

Mr. Wilson: If you would have produced here, Mr. Maddox, the ones we requested some weeks ago in our letter, I think we can take from that group the ones we are particularly interested in.

Mr. Maddox: Well, you tell me which ones you want.

The Court: Perhaps we had better recess for ten minutes.

Mr. Wilson: That might help, your Honor.

The Court: Recess for ten minutes.

(A ten-minute recess was taken.)

The Court: Proceed, gentlemen.

Mr. Wilson: Mr. Maddox, I should like first the Air Reduction Company consolidated and excess profits tax return for 1919.

[fol. 236] This return was used on a portion of Mr. Adams' examination, your Honor, and I should like to offer it in evidence to complete the record.

The Court: It will be received in evidence as Petitioner's Exhibit No. 35.

(The tax return was marked Petitioner's Exhibit 35 and received in evidence.)

Mr. Wilson: The next return is the return of the Air Reduction Company for the year 1934.

Mr. Maddox: Here it is.

Mr. Wilson: I offer that tax return in evidence.

Mr. Maddox: Now, I ask first: what is the purpose of introducing this return?

Mr. Wilson: Your Honor, I want to introduce that to

show that at all times there was a full and complete disclosure of the operating relationships here and also because I believe—I may be in error on this—that Mr. Maddox used that return in questioning at least one witness. I think it is necessary to complete the record.

Mr. Maddox: I used the return, I think, to refresh a witness' recollection as to the similarity of the typical contract here with other contracts, to save the introduction of some fourteen or fifteen contracts. I didn't use that return as such. It was just to refresh the witness' recollection. I object to the introduction of that return. It has no relevancy to any issue in this case.

The Court: Well, it is difficult for me to see where that return would be of any help to the Court in deciding the issue that we have here to decide.

Mr. Wilson: Well, your Honor, I should like to offer it to show that over the years, and long prior to 1938, facts regarding our operations were fully made known to the Government, relied upon and disclosed.

The Court: Well, that seems to have been established by the evidence, but would not constitute and could not constitute an estoppel, and it seems to me that it would not be relevant. I don't see any relevancy.

Mr. Wilson: I should like to suggest its offer for the limited purpose, not of establishing the facts that are in the return, but merely to show how we have reported the facts in that year 1934.

The Court: Well, I should think that the year 1938, [fol. 237] which we have before us, if you wish to introduce the income tax return of the paying corporation for the limited purpose of showing that fact, I think it would be relevant. It seems to *be* it would. But for the year 1934, it seems to me it would not be.

Mr. Wilson: I think perhaps it may have some relevancy and materiality because of the further reason that 1934 was the first year for which consolidated tax returns were not permitted, and, therefore, I think this is rather an important milestone in the whole series of income tax returns, and it may show——

The Court: Well, I have tried to be liberal in the receipt of evidence from both sides, but the introduction of income

tax returns should not be indulged in unless they have some real relevancy, and when one party objects to them and there isn't any apparent relevancy, I have to sustain the objection.

I will sustain the objection to the introduction of the 1934 return of the paying corporation.

Mr. Wilson: Just for the purpose of the record, your Honor, I should like also to demand the production, and to offer in evidence, the income and excess profits tax return of the National Carbide Corporation for 1934, and also the income and excess profits tax return of Pure Carbonic Company of America for 1934.

Mr. Maddox: You said National Carbide?

Mr. Wilson: Yes.

Mr. Maddox: And Pure Carbonic of America?

Mr. Wilson: Yes.

Mr. Maddox: Do I understand that as an offer?

Mr. Wilson: I am calling for their production and I should like to offer them for the record.

Mr. Maddox: I make the same objection that I made to the return of the Air Reduction Company for 1934. It has no relevancy and perfinency to the issues in this case. It is simply a claim of the vested interest and perhaps a mistake, you might call it, if that could be established, which the return could not establish, and there is no such issue in this case. We have a very definite issue here and these returns have no bearing on it.

The Court: I sustain the objection.

Mr. Wilson: May I then just have them marked for identification and note an exception?

The Court: All right. We will mark the one previously excluded for identification as Petitioner's Exhibit No. 36, [fol. 238] and the second group excluded will be marked for identification as Petitioner's Exhibits 37 and 38.

(The income tax returns were marked Petitioner's Exhibits 36, 37, and 38 for identification.)

Mr. Wilson: I offer in evidence the income tax return of Air Reduction Company, Inc., for 1938. The original return, and also the amended return. Perhaps they might be marked as one exhibit.

Mr. Maddox: I would like you to state for the record, for

my information, before I make any objection, what the purpose of this offer is.

Mr. Wilson: Well, Mr. Maddox, you put in evidence, as I recall, the returns of the three subsidiaries for the year 1938.

Mr. Maddox: That is true.

Mr. Wilson: And I think that in order to complete the picture as reported, we must have also in evidence the return of the parent company, and it is in order to complete that picture that I should like to make the offer.

Mr. Maddox: The returns of the three Petitioners here, were offered. Air Reduction Company is not the Petitioner, and I would object to the offer of this return on the basis on which Mr. Wilson has stated. There is no ground for it going in the record simply for that purpose. And I have the further objection that it is simply a self-serving declaration by the Petitioners here on the case that your Honor has to decide. I object to it on the ground.

The Court: If it is limited to the purpose of showing the method used by payer corporation of returning the income, it would be admissible. Of course, it isn't admissible to introduce returns to prove facts, but if it is limited to that purpose, it is admissible.

Mr. Wilson: I will offer it on the basis that your Honor has just indicated.

Mr. Maddox: That is, simply to indicate the method used.

The Court: The method used by the paying corporation of returning income on this setup. It will be received in evidence as Petitioner's Exhibit 39.

(The income tax return was marked Petitioner's Exhibit 39 and received in evidence.)

Mr. Wilson: Petitioners rest, your Honor.

. . . . . .

[fol. 238-1] PETITIONER'S EXHIBIT 2

Agreement, dated March 1, 1917, between Air Reduction Company, Incorporated, a corporation of the State of New York, herein called "Airco," of the first part, and Air

Reduction Sales Company, a corporation of the State of Delaware, herein called "Sales", of the second part:

Witnesseth:

That for good and valuable considerations each to the other given and received, the parties hereto hereby agree as follows:

First: Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases, which it or its subsidiary or controlled companies now own or control, or which it or they may hereafter build or acquire; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants.

Second: This contract, and the said employment of Sales hereunder, shall continue until December 31st, 1917; and thereafter shall continue from year to year subject to the right of either party to terminate the same at any time by giving thirty days previous written notice to the other of its intention so to do.

Third: Airco agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment, and ship-
[fol. 238-2] ping facilities, which it now owns or may hereafter acquire; (2) to supply such working capital as Sales may need; (3) to provide such executive management (but not accounting, bookkeeping and clerical service) and office accommodation and facilities as may be necessary for the proper conduct of Sales business; and (4) to procure from Sales such contracts with Airco's subsidiary or controlled companies as will enable Sales to exercise in each case the agency hereby created, and as will in each case constitute Sales the agent of such subsidiary or controlled company.

[fol. 238-2] Fourth: Sales agrees (1) to manage and operate efficiently and carefully all of said plants; (2) to maintain the same in first class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation and for wear and tear not immediately

replaceable by repairs; (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible, realizing, to the best of its ability, the largest obtainable gross receipts therefrom; (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (5) to credit monthly on its books to Airco all profits accruing to it from the operation of its entire business, over and above an amount equal to six per cent (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Airco upon demand any profits becoming due and credited to Airco as aforesaid.

[fol. 238-3] In witness whereof, the parties hereto have executed and delivered these presents as of the day and year first above written.

Air Reduction Company, Incorporated by Walter W. Birge, President.

Attest: M. W. Randall, Secretary.

Air Reduction Sales Company, by Walter W. Birge, President.

Attest: C. C. Emerson, Asst. Secretary.

Petitioners' Exhibit 22.

Organization and Functional Chart.

(Photoprint.)

[*For the Convenience of Court and Counsel this Exhibit (Photostatic Copy) is Bound in on the Opposite Page.*]

(Here follows 1 Photolithograph, side folio 238-4 and 1 paster, side folio 238-5)

Note:

Page 258A is large chart on Card 4.

—Cameraman

[fol. 238-5]

PETITIONERS' EXHIBIT 23

AIR REDUCTION COMPANY, INCORPORATED

Officers of Air Reduction Company, Incorporated and Agency Companies
During the Year 1938

Name of Officers	Offices Held				
	Air Red. Co., Inc.	Air Red. Sales Co.	Pure Carbonic, Inc.	Nat. Carbide Corp.	Wilson Welder & Metals Co.
C. E. Adams	Chairman of Board of Directors & Chairman of Company	Chairman of Board of Directors & Chairman of Company	Chairman of Board of Directors	Chairman of Board of Directors	Chairman of Board of Directors
A. R. Ludlow	Vice Chairman & Director	Vice Chairman & Director	President & Director		Director
C. S. Munson	President & Director	President & Director	Director	President & Director	Director
T. B. Hasler					President & Director
M. W. Randall	Vice President	Vice President	*Vice President & Director		Vice President
H. Van Fleet	Vice President & Operating Manager	Vice President & Operating Manager & Director			
C. D'W Gibson	Vice President in Charge of Sales	Vice President in Charge of Sales			
W. C. Keeley	Vice President	Vice President		Director	Director
F. J. Metzger	Vice President in Charge of Development and Research	Vice President in Charge of Development & Research			
*W. W. Ogier, Jr.			*Executive Vice President & Director		
R. J. Rowen			Vice President		
T. W. Gibson			Vice President		
*G. C. Cusack			*Vice President in Charge of Sales		
E. C. Ackerman				Vice President	
R. B. Davidson	*Secretary	Secretary & Director	Secretary & Director	Secretary	Secretary
R. W. Ryder	Treasurer	Treasurer	Treasurer	Treasurer	Treasurer
E. C. Turner	Asst. Vice President	Asst. Vice President			
G. E. Hawkins	Asst. Vice President	Asst. Vice President	Vice President		
R. A. Sossong	Asst. Vice President	Asst. Vice President	Vice President		
L. A. Hull	Asst. Vice President	Asst. Vice President			
T. C. Harrison	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary
E. R. Humann	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary
A. J. Thoma	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary	Asst. Secretary
E. R. Holmes	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer
F. J. McCulloch	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer
F. B. Adams, Jr.	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer	Asst. Treasurer
A. Andersen					Asst. Treasurer

The salary of each officer listed above was paid out of the funds of Air Reduction Co., Inc.

* Held office during part of year.

[fol. 238-6]

PETITIONERS' EXHIBIT 33

AIR REDUCTION COMPANY, INCORPORATED

Officers authorized to sign checks on Bank Accounts

Officers of Air Reduction Company, Incorporated, Air Reduction Sales Company, National Carbide Corporation, Pure Carbonic, Inc. and Wilson Welder & Metals Co., Inc., any two of whom are authorized to sign checks, drafts and orders against any and all funds to credit of each corporation with banks.

Air Reduction Co., Inc.	Air Reduction Sales Co.	National Carbide Corporation	Pure Carbonic, Incorporated	Wilson Welder & Metals Co., Inc.
Meeting held April 13, 1938; Minutes, pages 181–182.	Meeting held April 14, 1938; Minutes, pages 13–16, 32 & 37.	Meeting held April 21, 1938; Minutes, pages 17–20.	Meeting held May 5, 1938; Minutes, pages 19–24.	Meeting held April 28, 1938; Minutes, pages 15–16.
C. E. Adams	C. E. Adams	C. E. Adams	C. E. Adams	C. E. Adams
A. R. Ludlow	A. R. Ludlow		A. R. Ludlow	
C. S. Munson	C. S. Munson	C. S. Munson		
M. W. Randall	M. W. Randall			M. W. Randall
W. C. Keeley	W. C. Keeley			
L. A. Hull	L. A. Hull			
R. W. Ryder	R. W. Ryder	R. W. Ryder	R. W. Ryder	R. W. Ryder
E. R. Holmes	E. R. Holmes	E. R. Holmes	E. R. Holmes	E. R. Holmes
F. J. McCulloch	F. J. McCulloch	F. J. McCulloch	F. J. McCulloch	F. J. McCulloch
F. B. Adams, Jr.	F. B. Adams, Jr.	F. B. Adams, Jr.	F. B. Adams, Jr.	F. B. Adams, Jr.
		E. C. Ackerman		
				T. B. Hasler
				A. Andersen
			W. W. Ogier, Jr.	
			R. J. Rowen	
			T. W. Gibson	

[fol. 238-7] INDEX OF EXHIBITS

(Exhibits marked with asterisk are reproduced herein. The other exhibits are omitted pursuant to stipulation but are available for reference.)

Exhibits of Petitioners (Respondents on Appeal)

Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
1	Certificate of Incorporation of Air Reduction Company, Incorporated, with amendments	93
* 2	Agreement dated March 1, 1917, between Air Reduction Company, Incorporated and Air Reduction Sales Company	107
3	Agreement dated March 1, 1917, between Air Reduction Sales Company and Air Reduction Company of New Jersey	108
4 (a)	Letter dated May 16, 1936, from Air Reduction Company, Incorporated to Air Reduction Company of New Jersey	112
(b)	Bill of Sale dated May 28, 1936 from Air Reduction Company of New Jersey to Air Reduction Sales Company	
(c)	Certificate of Dissolution of Air Reduction Company of New Jersey, dated June 3, 1936	
5 (a)	Minutes of Special Meeting of Board of Directors of Air Reduction Company, Incorporated, held June 29, 1927	115

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
5 (b)	Contract dated July 6, 1927 between United Oxygen Manufacturing Company and The U. G. I. Contracting Company, Sellers and Air Reduction Company, Incorporated, Purchaser	
(c)	Letter of Designation dated July 8, 1927 from Air Reduction Company, Incorporated to United Oxygen Manufacturing Company and The U. G. I. Contracting Company	
(d)	Letter dated July 8, 1927 from The U. G. I. Contracting Company to Air Reduction Company, Incorporated, enclosing deeds	
(e)	Bill of Sale dated July 8, 1927 from United Oxygen Manufacturing Company to Air Reduction Sales Company	
(f)	Bill of Sale dated July 8, 1927 from The U. G. I. Contracting Company to Air Reduction Sales Company	
(g)	Receipt for stock certificates dated July 8, 1947 from United Oxygen Manufacturing Company to Air Reduction Company, Incorporated	115
(h)	Receipt for stock certificates dated July 8, 1927 from The U. G. I. Contracting company to Air Reduction Company, Incorporated	
6	Agreement dated August 25, 1922 between National Carbide Corporation and National Carbide Sales Corporation	

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
7 (a)	Minutes of Regular Meeting of Board of Directors of Air Reduction Company, Incorporated held July 8, 1936	118
(b)	Letter dated July 31, 1936 from Air Reduction Company, Incorporated, to National Carbide Corporation	
(c)	Bill of Sale dated July 31, 1936 from National Carbide Corporation (Va.) to Air Reduction Company, Incorporated	
(d)	Bill of Sale dated July 31, 1936 from National Carbide Corporation (Va.) to National Carbide Sales Corporation (Del.)	
(e)	Certificate of Dissolution of National Carbide Corporation (Va.) dated July 31, 1936	
(f)	Certificate of Amendment of Certificate of Incorporation of National Carbide Sales Corporation dated August 1, 1936	
8	Supplemental Agreement dated August 1, 1936 between Air Reduction Company, Incorporated and National Carbide Corporation (formerly named Nat'l. Carbide Sales Corp.)	120
9	Agreement dated October 1, 1929 between Pure Carbonic Company of America and Pure Carbonic, Inc.	126

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
10 (a)	Minutes of Special Meeting of Board of Directors of Air Reduction Sales Company held October 9, 1929	129
(b)	Minutes of Special Meeting of Board of Directors of Pure Carbonic Company of America held October 29, 1929	
11 (a)	Contract dated February 19, 1930 between Pure Carbonic Company of America, Natural Carbonic Gas Company, Natural Carbonic Ice Company, Air Reduction Company, Inc. and U. S. Industrial Alcohol Company	133
(b)	Minutes of Meeting of Board of Directors of Pure Carbonic Company of America held February 27, 1930	
(c)	Bill of Sale dated March 28, 1930 from Natural Carbonic Gas Company to Pure Carbonic, Inc.	
(d)	Bill of Sale dated March 28, 1930 from Natural Carbonic Ice Company to Pure Carbonic, Inc.	
(e)	Certificate of Dissolution of Natural Carbonic Gas Company dated June 26, 1930	
(f)	Certificate of Dissolution of Natural Carbonic Ice Company dated July 29, 1930	
12 (a)	Bill of Sale dated July 30, 1936 from Pure Carbonic Company of America to Air Reduction Company, Inc.	135

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
12 (b)	Certificate of Dissolution of Pure Carbonic Company of America (a Delaware Corporation) dated July 30, 1936	135
13 (2 folders.)		
	Folder #1:	
	(a) Letter of Direction dated July 31, 1936 from Air Reduction Company, Inc. to Dry Ice, Inc. (incorporated 1934 Delaware)	138
	(b) Bill of Sale dated July 31, 1936 from Dry Ice, Inc. (incorporated 1934 Delaware) to Air Reduction Company, Inc.	
	(c) Bill of Sale dated July 31, 1936 from Dry Ice, Inc. (incorporated 1934 Delaware) to Dry Ice, Inc. (incorporated 1936 Delaware)	
	(d) Certificate of Dissolution of Dry Ice Inc. (incorporated 1934 Delaware) dated July 31, 1936	
	Folder #2:	
13	(a) Letter of Direction dated September 30, 1937 from Air Reduction Company, Inc. to Dry Ice, Inc. (incorporated 1936 Delaware)	
	(b) Bill of Sale dated September 30, 1937 from Dry Ice, Inc. (incorporated 1936 Delaware) to Air Reduction Company, Inc.	

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
13 (c)	Bill of Sale dated September 30, 1937 from Dry Ice, Inc. (incorporated 1936 Delaware) to Pure Carbonic, Inc.	138
(d)	Certificate of Dissolution of Dry Ice, Inc. (incorporated 1936 Delaware) dated October 1, 1937	
14	Bill of Sale dated May 18, 1938 from Alabama Carbon Dioxide Ice, Inc. to Pure Carbonic, Inc.	141
15 (a)	Minutes of Special Meeting of Board of Directors of Wilson Welder & Metals Co., Inc., held June 30, 1936	144
(b)	Certificate of change of statement respecting capital, reduction of amount of capital and reduction of number of shares of Wilson Welder and Metals, Co., Inc., dated June 30, 1936	
(c)	Bill of Sale dated July 31, 1936 from Wilson Welder and Metals Co., Inc. to Air Reduction Company, Inc.	
(d)	Letter dated July 31, 1936 from Wilson Welder and Metals Co., Inc. to Air Reduction Company, Inc.	
16	Agreement dated August 1, 1936 between Air Reduction Company, Inc. and Wilson Welder and Metals Co., Inc.	145

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
17	Minutes of meeting of stockholders and Board of Directors of Air Reduction Company, Inc. for the year 1938	150
18	Minutes of meetings of stockholders and Board of Directors of Air Reduction Sales Company for the year 1938	151 287
19	Minutes of meetings of stockholders and Board of Directors of National Carbide Corp. for the year 1938	151 287
20	Minutes of meetings of stockholders and Board of Directors of Pure Carbonic, Inc. for the year 1938	151 287
21	Minutes of meetings of stockholders and Board of Directors of Wilson Welder and Metals Co., Inc. for the year 1938	151 287
*22	Organization and functional chart of Air Reduction Company, Inc., 1938	153
*23	Officers of Air Reduction Company, Inc. and agency companies during the year 1938	154
24 (a)	Appropriation request #2824 for Air Reduction Sales Co., October 19, 1938	160
(b)	Appropriation request #2819 for National Carbide Corporation, September 7, 1938	

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
	(c) Appropriation request #2826 for Pure Carbonic, Inc. October 21, 1938	160
	(d) Appropriation request #2828 for Wilson Welder & Metals Co., Inc. September 23, 1938	
	(e) New request for appropriations submitted to Board of Directors of Air Reduction Company, Inc., Wednesday October 26, 1938. (See minutes of Board of Directors of Air Reduction Company, Inc. for the year 1938 at pages 220-221; Exhibit No. 17.)	
25	Dividend notices December 8, 1937, March 9, 1938 and March 8, 1939	251
26	Genera' catalogue #21 of Airco Products, August 1938	252
27	Medium Pressure Oxyacetylene App. Engineering Dept. Bulletin #17	253
28 (a)	"Airco Acteylene" Bulletin issued June 1936	254
	(b) "The Airco-DB #10 Radiagraph" July 1938	
29	Welding and Cutting Show Bulletin February 1935	256
30 (a)	Airco exhibit at American Mining Congress Coal Show, Cincinnati, Ohio, May 11-15, 1936	258

[fol. 238-15]

Exhibit No.		Nature of Exhibit	Page of Certified Transcript of Record
30	(b)	Airco exhibit at Exhibition of Pa. State Association of the National Association of Power Engineers, Reading, Pa., June 26, 28, 1936	258
	(c)	Air Reduction exhibit at National Metals Exposition, Cleveland, Ohio, October 9-23, 1936	
	(d)	Air Reduction exhibit at New York Power Show, November 30-December 4, 1936	
	(e)	Airco exhibit in connection with manufacturers' exhibits at Milwaukee Purchasing Agents Exhibition, April 6-7, 1937	
31	(a)	Air Reduction exhibit at National Metals Exposition, Atlantic City, N. J., October 18-22, 1937 (first view)	259
	(b)	Air Reduction exhibit at National Metals Exposition, Atlantic City, N. J., October 18-22, 1937 (second view)	
	(c)	Air Reduction exhibit at National Metals Exposition, Atlantic City, N. J., October 18-22, 1937 (third view)	
32	(a)	Form for request for offers	283
	(b)	Form for purchase and general stores requisition (Form #224)	
	(c)	Form for purchase order and supplement to purchase order	

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Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
32 (d)	Form for emergency purchase order (Form #259B)	283
33	List of officers authorized to sign checks on bank accounts	287
34 (a)	Retirement income plan May 1, 1935	295
(b)	Premium statement of Aetna Life Insurance Co. May 1, 1938	
(c)	Check of Air Reduction Company Incorporated to Aetna Life Insurance Co. in payment of premium on group annuity contract, May, 1938	
(d)	Check dated May 2, 1938, of Air Reduction Company, Incorporated to Bankers Trust Company for contribution to retirement trust fund	
35	Corporation income and profits tax return of Air Reduction Co., Inc. for the calendar year 1919	440
36 (for Ident.)	Corporation income and excess profits tax return of Air Reduction Co., Inc. for the calendar year 1934	443
37 (for Ident.)	Corporation income and excess profits tax return of National Carbide Corporation for the calendar year 1934	443
38 (for Ident.)	Corporation income and excess profits tax return of Pure Carbonic Company of America for the calendar year 1934	443

[fol. 238-17]

Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
39	Corporation income and excess profits tax return of Air Reduction Co., Inc. for the calendar year 1938 with copy of 1938 capital stock tax return attached, and amended corporation income and excess profits tax return for the calendar year 1938	445

EXHIBITS OF RESPONDENT (Petitioner on Appeal)

A.	Corporation income and excess profits tax return of National Carbide Corporation for the calendar year 1938, with copy of 1938 capital stock tax return attached	413
B.	Corporation income and excess profits tax return of Pure Carbonic, Incorporated for the calendar year 1938, with copy of 1938 capital stock tax return attached	413
C.	Corporation income and excess profits tax return of Air Reduction Sales Co. for the calendar year 1938, with copy of 1938 capital stock tax return attached	414
D.	Minutes of regular meeting of the Board of Directors of Pure Carbonic Company of America held April 24, 1930	423
E.	Minutes of Special Meeting of Board of Directors of National Carbide Corporation held August 10, 1922	424

[fols. 238-18–296]

Exhibit No.	Nature of Exhibit	Page of Certified Transcript of Record
F.	Minutes of Special Meeting of Board of Directors of Air Reduction Sales Co. held February 21, 1918	426
G.	Minutes of Special Meeting of Board of Directors of Air Reduction Sales Co. held August 6, 1919	426
H.	Minutes of Special Meeting of Board of Directors of Air Reduction Sales Co. held December 31, 1921	427
I.	Minutes of first meeting of Board of Directors of National Carbide Sales Corporation held August 15, 1922	427
J.	Minutes of Special Meeting of Board of Directors of Pure Carbonic, Incorporated, held April 10, 1930	429

* * * * * * *

[fol. 296-a]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

ORDER OF CONSOLIDATION

[Caption omitted.]

Upon consideration of the motion of the petitioner on review filed herein consented to by counsel for respondents on review, and for case shown, *It is ordered:*

1. That the above-entitled causes be herein consolidated for recording, briefing, hearing and decision.

2. That certified records sur petitions for review be made upon separate Designations for record on review in the usual course and a complete transcript of record be made and filed only in the case of *Commissioner of Internal Revenue* v. *National Carbide Corporation, T. C. Docket No. 5822,* which shall include inter alia a copy of the consolidated Findings

of Fact and Opinion of the Tax Court of the United States promulgated in these proceedings, the Official Report of Proceedings, including oral testimony, before the Tax Court herein, and all the exhibits received in evidence and made a part of the record by the Tax Court herein (the original of such exhibits are to be filed with this Court without reproduction for the transcript of record), a copy of this order and a copy of any similar or related order entered in these causes; and that abbreviated transcripts of record, without duplications, be filed in the other two causes herein bearing *T. C. Docket Nos. 5823 and 5824,* all of which may be included under one cover; and that all matters contained in the full record in the case of *Commissioner of Internal Revenue* v. *National Carbide Corporation, T. C. Docket No. 5822,* shall [fol. 296-b] be taken and considered for all purposes as forming a part of the record on review in the other two causes herein, bearing *T. C. Docket Nos. 5823 and 5824* as fully as if contained therein, and shall have the same force and effect as if separate and complete records on review had been filed in such cases.

And it is further ordered that all of the original exhibits received in evidence by the Tax Court in the consolidated causes (marked "Petitioners' Exhibits" 1 to 39, both, inclusive, and "Respondent's Exhibits" A to J, both, inclusive), or photostatic copies substituted in lieu thereof by permission of the Tax Court and need not be reproduced for the purpose of the transcript of record on review hereinabove referred to, but that in lieu thereof the Clerk of the Tax Court is directed to transmit such original exhibits as part of the consolidated record herein to the Clerk of the Court ten days before these causes are set for argument in this Court upon direction of counsel for the petitioner on review and to be produced at the hearing of these causes by the Clerk of this Court for the benefit of the Court and counsel.

And it is further ordered that (1) the aforementioned exhibits need not be printed in the appendix to the respective briefs filed herein (except where either party may so desire to print in whole or in part any of such exhibits), but that said exhibits may be referred to by counsel in their respective briefs and on oral argument and considered by this Court with the same force and effect as if included in a printed appendix and (2) that the documents designated and included in the aforementioned abbreviated transcripts of

records on review in the cases of *Commissioner of Internal Revenue* v. *Air Reduction Sales Company, T. C. Docket No. 5823* and *Commissioner of Internal Revenue* v. *Pure Carbonic, Incorporated, T. C. Docket No. 5824,* and any other matters required under Rule 17 (a) of this Court relating to these two causes need not be printed and that the decision of this Court upon the complete record in the case of *Commissioner of Internal Revenue* v. *National Carbide Corporation, T. C. Docket No. 5822,* shall be the decision in the two aforementioned causes herein bearing *T. C.* [fol. 296-c] *Docket Nos. 5823 and 5824* but that separate judgments be entered in each of the three cases.

And it is further ordered that the Clerk of this Court transmit to the Clerk of The Tax Court of the United States four certified copies of this order, one of which to be included in the complete transcript of record filed in the case of *Commissioner of Internal Revenue* v. *National Carbide Corporation, T. C. Docket No. 5822.*

Jerome N. Frank, United States Circuit Judge.

Dated this 3rd day of September 1947.

A true copy.

Alexander M. Bell, Clerk. By A. Daniel Fusaro, Deputy Clerk.

* * * * * * *

[fol. 297] IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1947

Nos. 161, 162 and 163

(Argued March 5, 1948. Decided March 31, 1948)

Docket Nos. 20749, 20750 and 20751

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

NATIONAL CARBIDE CORPORATION, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

AIR REDUCTION SALES COMPANY, Respondent

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

PURE CARBONIC, INC., Respondent

[fol. 298] Before: L. Hand, Swan and Frank, Circuit Judges.

On petitions by the Commissioner to review three orders of the Tax Court *en banc*, expunging deficiencies in income, and declared value excess profits, taxes assessed against the taxpayers for the year 1938.

Hilbert P. Zarky, for the petitioner.
John A. Wilson, for the respondents.

OPINION

L. HAND, Circuit Judge:

This case comes before us upon three petitions of the Commissioner to review orders of the Tax Court *en banc*, which expunged deficiencies in income, and declared value excess profits, taxes assessed against the taxpayers. The Commissioner had assessed each of the three companies in question upon the theory that they had received incomes during the year 1938; but the Tax Court held that "they were operated as branches or divisions" of their parent—

the Air Reduction Company, Inc., of New York, and that for this reason their net income was taxable against it and not against them. This is the only issue involved, and the facts as found by the Tax Court were in substance as follows.

All the shares of each of the companies, as well as of a fourth not here involved, were owned by the Air Reduction Company, Inc., which we shall speak of as "Airco," and which was engaged in four major fields of manufac- [fol. 299] ture, in each of which it made use of one of the subsidiaries. One—Air Reduction Sales Company—extracted and sold the constituents of air; another—National Carbide Corporation—made and sold calcium carbide; a third —Pure Carbonic, Inc.—made carbonic acid gas which it sold in gaseous, liquid and solid forms; the fourth, manufactured electric welding machines and the like. We need not speak of the series of combinations, dissolutions and associations by which "Airco" became the owner of the shares of the subsidiaries, because before 1938 the legal relations between them had been so simplified that each was operating under separate contracts, which were so nearly alike that one will serve as a pattern for all. The substance was as follows. The parent employed the subsidiary "as its agent to manage and operate * * * all plants for the production" of the products assigned to that particular subsidiary, and for the "manufacture of apparatus and containers" to transport the products; and it also employed the subsidiary "as its agent to market and sell * * * the output of all such plants." It agreed to give the subsidiary "the use of all cylinders, containers, motor trucks, equipment, and shipping facilities which it now owns or may hereafter acquire * * * to supply such working capital" as the subsidiary might need; "* * * to provide such executive management * * * and office accommodation and facilities as may be necessary for the proper conduct" of its business. In return, the subsidiary agreed "to manage and operate * * * said plants, * * * to maintain the same in first class condition, * * * to distribute, market and sell the product manufactured, * * * to pay all expenses of such operation, maintenance and selling * * * to collect all * * * proceeds resulting therefrom, * * * to credit monthly on its books to Airco all profits * * * above an amount equal to six per cent (6%) per [fol. 300] annum on its outstanding capital stock, which

said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services," and "to pay over to Airco upon demand, any profits becoming due." The accounts were kept strictly on this basis; "Airco" furnished all the assets held or used by the subsidiaries, and paid for them out of its own treasury; the officers of each subsidiary were officers of "Airco"; and the directors were directors of, "Airco," and never met except formally to ratify what had been done by the officers or directors of "Airco." One general main office in New York was maintained for all, and the direction and management of each was immediately conducted by "Airco." Upon this evidence the Tax Court found that the subsidiaries were merely "the corporate agents of Airco and were operated as incorporated branches or divisions of Airco"; and that "the income from the operations of petitioners which is in excess of six per cent of petitioners' outstanding capital stock belonged to and was the income and property of Airco as principal." Upon this finding it held that the case fell within the decision of the Supreme Court in *Southern Pacific Company* v. *Lowe*,* and our decision in *Munson Steamship Co.* v. *Commissioner*,** and expunged the assessments. Three judges dissented.

The question when a wholly owned subsidiary of a parent corporation shall be treated for purposes of income taxation as a separate taxable person, and when as merely a part of the corporate activities of the parent, has caused much difference of judicial opinion. In *Southern Pacific Company* v. *Lowe* * the Supreme Court treated the subsidiary as a mere screen and held that the income was the parent's. We ventured to explain this decision—especially [fol. 301] in the light of *Lynch* v. *Turrish* * and *Lynch* v. *Hornby* ** both decided the same day—on the ground that all the income had been earned before the Sixteenth Amendment had become effective; † and the same explanation would

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* 247 U. S. 330.

** 77 Fed. (2) 849.

** 247 U. S. 339.

* 247 U. S. 221.

† *Nixon* v. *Lucas*, 42 Fed. (2) 833.

cover *Gulf Oil Company* v. *Llewellyn* †† which came shortly thereafter. Be that as it may, in *Burnet* v. *Commonwealth Improvement Co.* ††† the Court declared that neither decision could "be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation"; and that both "cases presented peculiar situations." That is of course a familiar resource when a court wishes to escape an earlier decision which it is not willing any longer to treat as authoritative; and in *Moline Properties, Inc.* v. *Commissioner,*†††† the Court expressly declared that both decisions had been "held to lay down no rule for tax purposes." In *National Investors Corporation* v. *Hoey* ††††† and again in *Paymer* v. *Commissioner,*†††††† we declared, as best we could, what we understood that case to decide, and perhaps we shall gain nothing by going over the ground again. However, since the Tax Court after the fullest deliberation has come to an opposite conclusion, our unfeigned deference to it makes it, if not imperative, at least appropriate, for us to give our reasons for adhering to our former position. *Moline Properties, Inc.* v. *Commissioner, supra,*†††† which, as the last declaration of the Supreme Court, must be taken as authoritative, did indeed recognize that there were occasions on which [fol. 302] the formal existence of the subsidiary should be disregarded, but these were limited to cases where "the corporate form • • • is a sham or unreal." We think that the citation of *Gregory* v. *Helvering,** as authority for this, meant that the subsidiary was a "sham" when it was not created or used for some business purpose, but as a screen for another corporation which, or an individual who, was conducting the business. In *Gregory* v. *Helvering* * the taxpayer had organized a corporation only to serve as a means of transfer; it was used once and only for that purpose, and was dissolved as soon as it had done so. The Court held that it was not a "corporation" within the

†† 248 U. S. 71.
††† 287 U. S. 415, 420.
†††† 319 U. S. 436, 439.
††††† 144 Fed. (2d) 466.
†††††† 150 Fed. (2) 334.
†††† 319 U. S. 436, 439.
* 293 U. S. 465.

meaning of that term, as Congress must be understood to have used it, because in common speech, it means a jural person created to conduct industry, commerce, charity or some other commonly practised activity, and not to serve merely as an escape from taxation. Such a corporation might be in some contexts a "corporation"; but words are chameleons, which reflect the color of their environment, and in a tax statute "corporation" could not have been so intended.

This decision has at times been thought to trench upon the doctrine—which courts are never tired of repeating—that the rights resulting from a legal transaction otherwise valid, are not different, vis-a-vis taxation, because it has been undertaken to escape taxation. That is a doctrine essential to industry and commerce in a society like our own, in which, so far as possible, business is always shaped to the form best suited to keep down taxes. *Gregory* v. *Helvering, supra,** was no exception, in spite of the fact that it was the purpose for which the taxpayer created the corporation that determined the event; for it is not the presence of an accompanying motive to escape taxation [fol. 303] that is ever decisive, but the absence of any motive which brings the corporation within the group of those enterprises which the word ordinarily includes. Indeed, a corporation may be a "sham" and "unreal," when the only reason for its creation was "to deter the creditors of one of the partners," who organized it, for that is not an activity commonly understood to be corporate.* Our decision in *Munson SS. Co.* v. *Commissioner, supra,*** depended upon the particular statute involved; we held that the encouragement to shipbuilding, which Congress had proffered to builders, was an overriding consideration, which should be recognized, regardless of the form employed.

It is true that Reed, *J.*, also cited *Higgins* v. *Smith* † as an authority in *Moline Properties, Inc.* v. *Commissioner, supra,*†† and it does not appear from the opinion in that case that the court thought that Higgins had organized

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* 293 U. S. 465.

* *Paymer* v. *Commissioner, supra,* 150 Fed. (2) 334.

** 77 Fed. (2) 849.

† 308 U. S. 473.

†† 319 U. S. 436.

the Innisfail Corporation only to escape taxation, or for any other purpose which put it outside the fair intendment of the word. Certainly, we had not thought so, when the case was before us. The decision may therefore make it possible for the Treasury at times to disregard transactions between its shareholder and his corporation even though it be a "corporation" in the sense we mean, although it must be confessed that the differentia is left open. We read that decision more broadly in *United States* v. *Morris & Essex R. Co.*,††† but it does not follow that we should not be equally wrong to circumscribe it. Be that as it may, the taxpayers at bar can take no comfort from *Higgins* v. *Smith, supra,*† for, even though it may not be [fol. 304] a critical test that the shareholder has created the corporation to conduct some lawful business, it does not thereafter rest with him to assert that it is a screen, when he has used it as a convenient method of actually conducting his business. If this be right, the assessments were valid. "Airco" found it more convenient in its manufacture and distribution to adopt a quadripartite form than to deal directly with third persons itself. Whatever its reasons, they were business reasons, and the corporations it used were "corporations" within any interpretation of the law. That is enough; it must accept the consequences of that choice; and it is not material that it retained the direction of their affairs down to the minutest detail, that it provided them with their assets, that it stood back of their liabilities and took all their profits. Even though *Southern Pacific Co.* v. *Lowe, supra,** set up a different test, we regard it as *pro tanto* no longer controlling.

There remains only the vexed question whether we should yield our own judgment to that of the Tax Court** The facts are not in dispute, for the argument is plainly untenable that the Tax Court's declaration that the income from the three businesses "was the income and property of Airco as principal," was a finding of fact; on the contrary, that was exactly the issue on which the whole case turned. Moreover, the Tax Court's decision was altogether

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††† 135 Fed. (2) 711, 713.

† 308 U. S. 473.

* 247 U. S. 330.

** *Dobson* v. *Commissioner*, 320 U. S. 489.

based upon an interpretation of the decisions of the Supreme Court, and of the circuit courts of appeal, especially upon *Munson SS. Co.* v. *Commissioner, supra.*† Concededly, it is impossible to lay down any general principle to distinguish those situations in which a "clear-cut question of law" arises; and even more so to distinguish [fols. 305-306] those in which we should treat the Tax Court's general familiarity with the subject-matter as conferring upon its decisions greater immunity from review than the decisions of other courts. We cannot believe, however, that even such specialists as the judges of that court are to be deemed in a better position to interpret the meaning of novices than the novices themselves: rather the opposite. Yet what this appeal in the end comes down to is whether "lay judges"—so to say—shall determine the meaning of other "lay judges" without weighting the scales in favor of an earlier decision of "expert judges." If they are not free to do so, we find it hard to imagine a case in which they ever could be.*

Orders reversed; the assessments reinstated.

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† 77 Fed. (2) 849.

* *Trust of Bingham* v. *Commissioner*, 325 U. S. 365; *Commissioner* v. *Wilcox*, 327 U. S. 404; *Crane* v. *Commissioner*, 331 U. S. 1.

[fol. 307] IN UNITED STATES CIRCUIT COURT OF APPEALS,
SECOND CIRCUIT

[Caption omitted]

No. 20749

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

NATIONAL CARBIDE CORPORATION, Respondent

Appeal from The Tax Court of the United States

JUDGMENT—Filed March 31, 1948

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed and assessment reinstated in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 308] [File endorsement omitted.]

[fol. 309] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

[Caption omitted]

No. 20750

COMMISSIONER OF INTERNAL REVENUE, Petitioner;

v.

AIR REDUCTION SALES COMPANY, Respondent

Appeal from The Tax Court of the United States

JUDGMENT—Filed March 31, 1948

This cause came on to be heard on the transcript of record from The Tax Court of the United States and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed and assessment reinstated in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

[fol. 310] [File endorsement omitted.]

Alexander M. Bell, Clerk.

[fol. 311] IN UNITED STATES CIRCUIT COURT OF APPEALS
SECOND CIRCUIT

[Caption omitted]

No. 20751

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

PURE CARBONIC, INC., Respondent

Appeal from the Tax Court of the United States

JUDGMENT—Filed March 31, 1948

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed and assessment reinstated in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 312] [File endorsement omitted.]

[fol. 313] IN THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

(Argued March 5, 1948. Decided March 31, 1948)

Docket No. 20749

Docket No. 20750

Docket No. 20751

[Titles omitted]

RESPONDENTS' PETITION FOR REHEARING—Filed April 15, 1948

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Second Circuit:

National Carbide Corporation, Air Reduction Sales Company and Pure Carbonic, Incorporated, respondents in the [fol. 314] above entitled causes respectfully present this petition for a rehearing and in support thereof set forth:

1. This Honorable Court on March 31, 1948 filed its written opinion in these consolidated causes reversing the orders and decisions of The Tax Court of the United States which held that there were no deficiencies in income taxes and declared value excess profits taxes of the respondents for the calendar year 1938, and reinstated the assessments of deficiencies made by the Commissioner of Internal Revenue.

2. During the calendar year 1938 each of the respondent subsidiary-companies operated pursuant to an express contract with its parent corporation, Air Reduction Company, Incorporated, hereinafter called "Airco." In each such contract Airco agreed to give each respondent the use of all gas cylinders and containers, trucks, equipment and shipping facilities which it owned; to supply each respondent with working capital; and to provide executive management and office accommodations and facilities for each. Moreover, all assets held and used by the three respondents were furnished to them by Airco which paid for them with its own cash or by exchange for Airco's stock.

In consideration for Airco furnishing these assets and services, each contract provided, among other things; that

the respondent should "credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six per cent. (6%) per annum of its outstanding capital stock.'"

During 1938 Airco included as its own income $881,244.30, $3,314,141.10 and $157,595.25, which represented the [fol. 315] amounts credited to Airco on the books of the respondents National Carbide Corporation, Air Reduction Sales Company and Pure Carbonic, Incorporated, respectively, in fulfillment of their obligations to Airco under their respective contracts and pursuant to the operating arrangements between the parent and its subsidiary companies.

3. The reason given by the Commissioner of Internal Revenue for making the deficiency assessments herein was that the contracts between the respondents and Airco should be disregarded. In determining the amount of the deficiencies claimed against each respondent, the Commissioner found that the sums of $881,244.30, $3,314,141.10 and $157,595.25, previously credited to Airco, were in fact a part of the taxable income of the respective respondents.

The Tax Court, on the other hand, sustained the validity of these contracts, pointing out: that the policy of operating under these contracts originated in 1917 (P. A. 11-12); that each contract has remained in force and unchanged in its terms from its inception down to the present time (P. A. 20); that the method by which Airco conducted its business through corporate agencies was consistently adhered to; and that all details of the relationship between Airco and each of the respondents were always fully disclosed to the Government and the Commissioner (P. A. 28).

The Tax Court concluded: that the relationship of principal and agent existed between Airco and its three subsidiaries, and held: that the respondents "were the corporate agents of Airco" and that their income in excess of 6% on their outstanding capital stock allowed by the contracts was the income and property of Airco "as principal" (P. A. 28).

[fol. 316] 4. This Court held in its opinion that each respondent company must be considered a separate corporation "within any interrpetation of the law." But the Court: (1) failed to discuss or to give recognition to the legal effect of the contracts, although set forth in its opinion; and (2) failed to determine whether under said contracts the

amounts credited by the respondents to Airco constituted a necessary business expense deductible from their respective incomes.

5. The Supreme Court in *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590 (1943), both in the prevailing and in the minority opinions, clearly recognized that a bona fide contract between a parent and a subsidiary corporation could not be ignored and must be given effect for tax purposes. The decision of the majority disallowing the claimed deduction as a necessary business expense of the parent was placed squarely upon the ground that there the subsidiary was engaged in a business which the parent could not legally do. In the instant case, on the contrary, the Tax Court found that the subsidiaries were not engaged in a business which it was illegal for Airco to do, and expressly held:

> "The Commissioner makes no contention that Airco and its subsidiaries operated in the manner shown in our findings of fact because it was illegal for Airco to do such business on its own account. On the contrary, the evidence affirmatively shows that such was not the reason for the manner of operation by Airco and its subsidiaries" (P. A. 34).

Moreover, even the majority opinion in the *Interstate* case recognized that if the record before the Court had segregated the "legal" business of the subsidiary from the [fol. 317] "illegal" business, the allowance to the parent corporation of that portion of the claimed deduction attributable to such "legal" business would have been approved pursuant to the contract between parent and subsidiary.

6. Although this Court has held that the subsidiaries are separate and independent corporations for tax purposes, the contracts here involved, whose existence and legality have been established by the findings of the Tax Court, cannot properly be ignored. Their legal consequences should be dealt with. The language of the Tax Court in *Customs Casing Co., Inc. et al.,* v. *Commissioner of Internal Revenue,* T. C. Memo., op. Docket Nos. 102719, 102721-4; 1943 C. C. H. Dec. No. 13194-M, is singularly applicable. The Tax Court there said:

> "If we disregard the corporate entities then clearly the losses of the subsidiary-agents absorbed and de-

frayed by Hygrade would be deductible by it as its own; while if we consider the subsidiary-agents as separate corporate entities, we must give effect to the agency contracts executed between them and Hygrade and, come to the conclusion indicated above; that Hygrade is entitled to the net receipts of the subsidiary-agents: * * *"

7. The case of *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436 (1943), is not determinative of the issue raised upon this petition, and does not preclude the rehearing now sought. For, in that case, unlike this case, the Court expressly pointed out that no contracts were involved (p. 440).

Wherefore, it is respectfully requested that a rehearing be granted and upon rehearing: (1) that this Court determine whether the amount credited to Airco on the books [fol. 318] of each respondent pursuant to its contract, is a necessary and proper business expense which should be allowed to the respective respondents as deductions in determining their taxable income; or (2) that legal effect be given to the contracts and that the orders and decisions of The Tax Court be affirmed.

Dated, New York, N. Y., April 14, 1948.

Respectfully submitted, National Carbide Corporation, Air Reduction Sales Company, Pure Carbonic, Incorporated, by John A. Wilson, Counsel for Respondents. Shearman & Sterling & Wright, Attorneys for Respondents, 20 Exchange Place, New York 5, N. Y.

Certificate of Counsel

We hereby certify that we are members of the firm of Shearman & Sterling & Wright, attorneys for National Carbide Corporation, Air Reduction Sales Company and Pure Carbonic, Incorporated, respondents herein; that we have acted as counsel for the respondents in this litigation; that the foregoing petition for a rehearing is not presented for purposes of delay but is, in our opinions, well founded in law and fact, and is proper to be filed herein; and that it

is entitled to the favorable consideration of this Honorable Court.

John A. Wilson, Harry W. Forbes.

[fol. 319] In United States Circuit Court of Appeals for the Second Circuit

[Titles omitted]

Denial of Petition for Rehearing

Per Curiam:

Petition for rehearing denied.

L. H. T. W. S. J. N. F., C.J.J.

Filed April 19, 1948.

[fol. 319a] [File endorsement omitted.]

[fol. 320] In United States Circuit Court of Appeals, Second Circuit

Commissioner of Internal Revenue, Petitioner,

v.

National Carbide Corporation, Respondent

Commissioner of Internal Revenue, Petitioner,

v.

Air Reduction Sales Company, Respondent

Commissioner of Internal Revenue, Petitioner,

v.

Pure Carbonic, Inc., Respondent

Order Denying Petition for Rehearing—Filed April 19, 1948

A petition for a rehearing having been filed herein by counsel for the Respondents,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

Alexander M. Bell, Clerk.

[fol. 321] [File endorsement omitted.]

[fol. 322] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 323] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 151

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 324] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 152

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 325] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 153

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied

the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: File No. 53, 153. 54, 154. 53, 155. U. S. Circuit Court of Appeals, Second Circuit. Term No. 151. National Carbide Corporation, Petitioner, vs. Commissioner of Internal Revenue. Term No. 152. Air Reduction Sales Company, Petitioner, vs. Commissioner of Internal Revenue. Term No. 153. Pure Carbonic, Inc., Petitioner, vs. Commissioner of Internal Revenue. Petition for writs of certiorari and exhibit thereto. Filed July 14, 1948. Term No. 151 O. T. 1948. 152 O. T. 1948. 153 O. T. 1948.

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CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 151

NATIONAL CARBIDE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 152

AIR REDUCTION SALES COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 153

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners

SHEARMAN & STERLING & WRIGHT
20 Exchange Place,
New York 5, N. Y.
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

Nos. , , and .

NATIONAL CARBIDE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AIR REDUCTION SALES COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, NATIONAL CARBIDE CORPORATION, AIR REDUCTION SALES COMPANY and PURE CARBONIC, INCORPORATED, hereby respectfully request this Honorable Court to issue writs of certiorari to the United

States Circuit Court of Appeals for the Second Circuit to review the decision and judgments of that Court which reversed the decisions and orders of The Tax Court of the United States in these proceedings.

The Tax Court, thirteen of the sixteen judges concurring, had set aside determinations by the Commissioner of Internal Revenue of deficiencies aggregating $1,066,253.10 in the 1938 corporation income and declared value excess profits taxes of petitioners.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. C, 1-9) is reported in 167 F. (2d) 304.

The findings of fact and opinion of the Tax Court (R. A, 5-36) are reported in 8 T. C. 594.

Jurisdiction.

The judgments of the Circuit Court of Appeals were entered on March 31, 1948 (R. C, 10, 12, 14). A petition for re-hearing was filed on April 15, 1948 (R. C, 16-21), and was denied, without opinion, on April 19, 1948 (R. C, 22, 24).

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13, 1925. After September 1, 1948, this will be Section 1254 of Title 28, United States Code.

Questions Presented.

The questions presented are as follows:

1. Where no question of "sham" or of "disregard of corporate entities" is involved, may a subsidiary

corporation be the agent of its parent so that the income from its operations is properly taxable to the parent, as the Tax Court has held?

2. Whether this Court's decision in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, "still stands", as decided by the Tax Court, or is "no longer controlling", as decided by the court below?

3. Should legal effect be given to express agency contracts between subsidiaries and their parent, which were always followed in all respects in all operations between them?

4. Can a Circuit Court of Appeals properly reverse a decision of the full bench of the Tax Court in which the Tax Court expressly found and held that subsidiaries "were corporate agents" of their parent, and that the income from their operations "belonged to and was the income and property" of the parent "as principal"?

Statutes and Regulations Involved.

These cases do not involve the construction or application of any specific statutes or regulations bearing directly on the issues.

Summary Statement of Facts.

The facts found by the Tax Court (R. A, 5-28) establishing the agency relationship, may be summarized as follows:

Each of the three petitioners was a wholly owned subsidiary of Air Reduction Company, Incorporated,

commonly known and herein sometimes referred to as "Airco" (R. 7*). Airco, the parent company, was engaged in the manufacture of gases and equipment for gas and electric-arc welding, cutting and heat treatments of metals. It utilized the three petitioners in three related branches of its business.

The Operating Contracts.

With each petitioner, Airco had an express operating contract. These contracts follow the pattern established on March 1, 1917 in the contract between Airco and Air Reduction Sales Company (R. 11-12).

In each contract Airco agreed to give each subsidiary the use of all gas cylinders and containers, trucks, equipment and shipping facilities which it owned; to supply each subsidiary with working capital; and to provide executive management and office accommodations and facilities for each (R. 12).

All assets held and used by the three subsidiaries were furnished to them by Airco which had paid for them with its own cash or by exchange for Airco's stock. All working capital was supplied by Airco (R. 21, 31).

In consideration of Airco furnishing these assets and services, each contract provided, among other things, that the subsidiary should "credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six percent. (6%) per annum of its outstanding capital stock" (R. 12-13).

Some of the salient facts found by the Tax Court, in addition to those relating to the operating con-

* References are made to the Findings of Fact of the Tax Court, printed in Part A of the Record.

tracts, which establish that the business of Airco was conducted through its subsidiaries as agents, were:

Board of Directors.

The Airco Board held regular meetings, determined the general policies, and completely controlled the business of Airco and each subsidiary (R. 22, 28, 31).

Directors of the subsidiaries, with one minor exception, were all senior officers of Airco. These Boards held an organization meeting each year and thereafter met only to formalize action taken by the Airco Board (R. 28, 30, 31).

Officers.

The officers of the subsidiaries were the officers of Airco and they exercised complete control, administration and management over the business of each of the subsidiaries in accordance with the policies and directions of the Airco Board (R. 21, 22, 31). Airco maintained one general office in New York for all companies (R. 20, 22).

Branches of the Business.

The business of Airco and the subsidiary companies was divided into six main branches, each headed by an officer of Airco. All employees in these branches performed their duties whenever and wherever required in connection with the operations of all companies (R. 22-23, 31).

Bank Accounts.

Bank accounts in the names of the subsidiaries were drawn upon by Airco indiscriminately whenever cash was needed for its own use or for any subsidiary no matter in whose name the account was kept (R. 25-26, 32).

Accounting.

All accounts were kept strictly in accordance with the operating contracts. The value of all assets held and used by each subsidiary, all working capital furnished to it and the net proceeds from its operations in excess of its compensation under its contract, were credited to the accounts payable by the subsidiary to Airco and were debited to the accounts receivable by Airco from the subsidiary. No interest ran on any of these accounts (R. 21, 27, 32).

There were no inter-company profits (R. 25, 31-32). None of the subsidiaries declared dividends (R. 27). The proceeds realized from the operations of the subsidiaries went to Airco by reason of its method of operation and accounting under the operating contracts (R. 32).

Tax Returns.

During 1938, as in prior years, Airco reported all income from its operation of the subsidiaries, in excess of the nominal amount of each subsidiary's contract compensation, as its own, and paid taxes thereon accordingly (R. 10). The method by which Airco conducted its business and all details of the relationships between it and its subsidiaries were always fully disclosed to the Government and to the Commissioner (R. A; 28).

Adjustments made by the Commissioner.

In 1938, for the first time, the Commissioner disregarded the operating contracts and long established pattern of Airco's operation, eliminated from Airco's return the amounts credited to Airco on the books of each subsidiary and increased the income re-

ported by the three subsidiaries by these amounts (R. A. 5-6). The result was a large deficiency, which is in net effect almost wholly one of Declared Value Excess Profits Tax, resulting from attributing substantial incomes to the subsidiaries while giving them no benefit from the capital stock tax declaration of the parent.

Had Airco known that the Commissioner would change his position and refuse to accept for 1938 and later years Airco's method of reporting income, which he had accepted in prior years, Airco could properly have made different capital stock declarations for itself and its subsidiaries, thus removing any possibility of a claim for Declared Value Excess Profits Taxes.

Decision of the Tax Court:

In the Tax Court the proceedings were tried before Honorable Eugene Black and reviewed by the entire court. Thirteen judges concurred in the decision; only three dissented and they without opinion.

The Tax Court stated that the issue before it was:

> "* * * Whether, as the respondent has determined, the income from the operations of the three petitioners belonged not to Airco, the parent, but to the petitioners and was taxable to them; or whether, as the three petitioners contend, the income from the operations of the petitioners in 1938, exclusive of the small amounts paid to petitioners under the contracts, belonged and was taxable to Airco, the parent company, both because the petitioners were in fact incorporated departments, divisions or branches of Airco's

business and because the petitioners operated pursuant to express contract with Airco" (R. A, 28-9).

On all the evidence, the Tax Court's finding of ultimate fact was that:

> "Petitioners were the *corporate agents* of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six per cent of petitioners' outstanding capital stock belonged to and was the income and property of Airco as principal" (R. A, 28; italics ours).

Therefore, the Tax Court held: "That there are no deficiencies in income tax and declared value excess profits tax for the calendar year 1938." (R. A, 4-5).

Decision of the Circuit Court of Appeals.

The opinion below erroneously assumed that the Tax Court had merely held that the subsidiaries "were operated as branches or divisions" of Airco and that the Tax Court had, for that reason alone, held that their net income was taxable against Airco and not against the subsidiaries. It completely disregarded the express contracts and the agency relationship found as a fact by the Tax Court, saying:

> "'Airco' found it more convenient in its manufacture and distribution to adopt a quadripartite form than to deal directly with third persons itself. Whatever its reasons, they were business reasons, and the corporations it used were 'corporations' within any interpretation of the law. That is enough; it must accept the consequences

of that choice; and it is not material that it retained the direction of their affairs down to the minutest detail, that it provided them with their assets, that it stood back of their liabilities and took all their profits" (R. C, 8).

The Tax Court had cited *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, as "aptly descriptive of the relationship" between petitioners and Airco (R. A, 30). But the Circuit Court of Appeals after discussing *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, said:

> "Even though *Southern Pacific Co.* v. *Lowe*, *supra*, set up a different test, we regard it as *pro tanto* no longer controlling" (R. C, 8).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that a subsidiary corporation cannot be the agent of its parent so that the income from the operations of the subsidiary is in law, as well as in fact, the income of the parent.

2. In holding the decision of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, to be "*pro tanto* no longer controlling".

3. In failing to give legal effect to clear and bona fide operating contracts between the subsidiary corporations and their parent under which the subsidiaries became agents of their parent, and in failing to hold that the amounts payable to the parent under the contracts are the income of the parent, as principal, taxable to it.

4. In exceeding its powers of review by reversing the Tax Court which had expressly found and held that the subsidiaries were "the corporate agents" of their parent and that the income from the operations of the subsidiaries "belonged to and was the income and property of Aireo as principal".

5. In failing to hold, if the income is to be treated as belonging to the subsidiaries, that amounts payable by the subsidiaries to Aireo pursuant to bona fide operating contracts were deductible as ordinary and necessary business expenses of the subsidiaries or, in the alternative, in failing to remand the proceedings to the Tax Court for the determination of that issue.

Reasons for Granting the Writs.

1. The decision of the Circuit Court of Appeals is in conflict with the decision of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, and with the direct implication of this Court's decisions in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, and in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590.

The court below treated the case as one involving the "disregard of corporate entity". But this ignores the real question here which is whether the existence of the agency relationship, expressly found by the Tax Court, is to be given its legal effect.

The court below decides that such an agency relation cannot be effective as a matter of law. This decision is in conflict with *Southern Pacific Co.* v. *Lowe*, *supra*, which likewise involved close relations between a subsidiary and a parent. There the subsidiary, as this Court said in *Peabody* v. *Eisner*, 247 U. S. 347,

349, decided the same day, acted "merely as its [the parent's] agent and subject in all things to its direction and control". The present case is also one of agency, as the Tax Court clearly held.

After quoting language from *Southern Pacific Co. v. Lowe*, 247 U. S. 330, to the effect that there the subsidiary acted as agent of its parent and was completely controlled by it, the Tax Court said (R. A. 30):

> "We think the foregoing words of the Supreme Court are aptly descriptive of the relationship which existed between petitioners and their parent, Aireo, in the instant case."

A little later it said (R. A. 32):

> ". . . We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe*, *supra*."

Finally, the Tax Court referred to the fact that the Commissioner had accepted returns from the taxpayers for the years 1935, 1936 and 1937, on the basis for which they now contend, and concluded (R. A. 36):

> "* * * Nevertheless, we think that his apparent interpretation of the law in 1935, 1936, and 1937 as it affected petitioners was correct and that the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe*, *supra*, still stands."

It is clear, therefore, that the full bench of the Tax Court regards *Southern Pacific Co.* v. *Lowe* as still law in cases of agency, and that it considered the present case to be a case of agency. But, the Circuit Court of Appeals refused to follow the *Southern*

Pacific case. It indicated (R. C, 5) that the *Southern Pacific* decision is one which the Supreme Court "is not willing any longer to treat as authoritative," and added (R. C, 8):

> "* * * Even though *Southern Pacific Co.* v. *Lowe*, *supra*, set up a different test, we regard it as *pro tanto* no longer controlling."

Thus, the Circuit Court of Appeals expressly rejects the decision of this Court in the *Southern Pacific* case, by which the full Tax Court had been guided.

The continuing validity of the *Southern Pacific* case within the field of actual agency relationship has been recognized by this Court in recent decisions. Thus, in *Moline Properties, Inc.* v. *Commissioner*, *supra*, which was heavily relied upon by the court below although its facts were wholly dissimilar, this Court had expressly pointed out (p. 440):

> "* * * There was no actual contract of agency, nor the usual incidents of an agency relationship."

In the present case, there were contracts of agency; all the usual incidents of agency relationship were present; and the Tax Court expressly found that the petitioners were "the corporate agents of Airco" (R. A, 28).

Likewise, in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, this Court said (p. 593):

> "This is not the case of a mere branch or division of a business conducted solely for convenience's sake under a separate corporate form."

In that case, this Court pointed to the absence of an important relationship, present in this case, in which the Tax Court has expressly found that the "Petitioners . . . . were operated as incorporated branches or divisions of Airco" (R. A, 28).

Furthermore, the decision of the Circuit Court of Appeals, gave no effect to the express operating contracts between Airco and its subsidiaries, and is in conflict with the implications of the decision of this Court in the *Interstate Transit Lines* case.

In that case, in both prevailing and minority opinions, this Court clearly recognized that a bona fide contract between a parent and a subsidiary should be given effect. The decision of the majority, opinion by Mr. Justice Reed, assumed the validity of the contract, and disallowed the claimed deduction only upon the ground that the subsidiary was engaged in a business which its parent, Interstate, could not legally do.

But, Mr. Justice Jackson in his dissenting opinion (Chief Justice Stone and Mr. Justice Murphy concurring) called the agreement between the two corporations a "commonsense business arrangement."

The operations in the present case were pursuant to contracts which originated in 1917, and which have remained unchanged and in full force from their inception to the present time. The Tax Court found that the method by which Airco conducted its business through corporate agencies was consistently adhered to, and that all details of the relationship between Airco and each of these subsidiaries were fully disclosed to the Government and the Commissioner (R. A, 11, 12, 20, 28).

Thus, the decision below erroneously rejects *Southern Pacific Co.* v. *Lowe*, and applies recent decisions of this Court to a factual situation which was expressly excepted in those decisions. *Southern Pacific Co.* v. *Lowe* has never been overruled, and the above-quoted language from the *Moline Properties* and *Interstate Transit* opinions was undoubtedly intended to preserve its applicability in the field of agency.

2. The Circuit Court of Appeals exceeded its powers of review and so far departed from the accepted and usual course of judicial procedure in like cases as to call for the exercise of this Court's powers of supervision and correction.

At the time this case was decided below, the decision of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489, was in effect. It has since been abrogated by the amendment to Section 1141(a) of the Internal Revenue Code which was made by Section 36 of the Act of June 25, 1948.* This development emphasizes the importance of review in the present case.

As we have shown, the issue below was whether an agency relation existed between the subsidiaries and their parent. That issue was basically one of fact to be determined upon the evidence. The case was tried at length before the Tax Court, and it expressly found that "Petitioners were the corporate agents of Airco", and that "The income from the operations of

* That section, as amended effective September 1, 1948, reads as follows: "The Circuit Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; . . ." (Public Law No. 773, 80th Congress, 2nd Session).

petitioners . . . belonged to and was the income and property of Airco as principal" (R. A. 28).

Under the *Dobson* rule, as it was effective when this case was decided below, we believe it entirely clear that the findings of fact and decision of the Tax Court should not have been interfered with by the Circuit Court of Appeals. The same conclusion should follow under the statute as it has now been amended. That statute directs that Circuit Courts of Appeals shall have the same power in reviewing decisions of the Tax Court as in reviewing "decisions of the district courts in civil actions tried without a jury."

This Court had established the rules of review in such cases before its decision in the *Dobson* case. For example, in *McCaughn* v. *Real Estate Land Title & Trust Co.*, 297 U. S. 606, this Court held that a Circuit Court of Appeals might not review a decision of a district court on the issue of contemplation of death, which involves a mixed question of law and fact. Similarly, in *Wilmington Trust Co.* v. *Helvering*, 316 U. S. 164, where the issue was whether certain sales were short sales or ordinary sales, this Court reversed the Circuit Court of Appeals, which had reversed the Board of Tax Appeals. It said (316 U. S. at 168):

> "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences. The court may not substitute its view of the facts for that of the Board. Where the findings of the Board are supported by substantial evidence they are conclusive."

Therefore, whether this case is regarded as coming under the *Dobson* rule, or under the scope of review as now applicable, the decision below was erroneous in that the Court exceeded its powers of review.

It is especially important in view of the abrogation of the *Dobson* rule that this Court announce anew the limitations on the scope of review of Tax Court decisions which basically involve only questions of fact.

3. We urge upon this Court that when there is a conflict between a Circuit Court of Appeals and the *full bench of the Tax Court,* on an important question in the tax field, the resolution of such conflict should, *prima facie,* be regarded as a matter of great public importance, justifying the grant of a writ of certiorari. This is particularly true where, as here, the conflict between the two courts is with respect to the controlling force and effect of a decision of this Court.

The relation of this Court to tax cases has long been one of concern. The system of waiting for conflicts to develop between Circuit Courts of Appeals has led to great delay in the final resolution of tax questions, and to uncertainty and confusion while the conflicts were developing. A system which leaves important tax questions *in limbo,* often for many years, until an appellate conflict develops has been overwhelmingly demonstrated as unsatisfactory and unsound.

Moreover, the tendency of Circuit Courts of Appeals to treat each case coming before them as *res nova,* and to decide each case independently of the

decision of the Tax Court can only create confusion and uncertainty. Although the *Dobson* case no longer stands, the problem vitally affecting the public interest still remains.

We do not urge that this Court should review every decision of a Circuit Court of Appeals reversing the Tax Court. Many of the decisions of the Tax Court are memorandum decisions by a single judge, and many others, though published, are likewise the decisions of a single judge. Only a small proportion of the decisions of the Tax Court are "Reviewed by the Court", as was the decision below (R. A. 36). These are ordinarily the cases which the Tax Court itself deems of exceptional importance and upon which it feels that the judgment of its entire membership should be brought to bear. In the present case we have a decision which is important, not only because it was by the full bench of the Tax Court, but because it deals with a tax question of wide and general interest and is consistent with the current of the decisions of the Tax Court over a period of years.*

The Tax Court is the great basic tribunal in tax cases. Nearly 90% of all tax cases are heard by the Tax Court. It has not merely a specialized jurisdiction, but a specialized experience and competence in tax cases. Its jurisdiction is not confined to one Circuit but is nation-wide. A conflict of decisions between *the full bench of the Tax Court* and a Circuit Court of Appeals presents, *prima facie*, a question of

* See, for example, *Custom Casing Co.* v. *Commissioner*, T. C. Memo. op. Docket Nos. 102719, 102721-4; 1943 C. C. H. Dec. No. 43194-M; 2 T. C. M. 58, which involved almost identical facts; *Seminole Flavor Co.* v. *Commissioner*, 4 T. C. 1215 (1945); *Baxter Machinery Co.* v. *Commissioner*, T. C. Memo. op. Docket Nos. 7780, 8950; 1947 C. C. H. Dec. No. 15908-M; 6 T. C. M. 806.

as great public importance as a conflict between two Circuit Courts of Appeals. Unless such a reversal in a case involving an important tax question is reviewed, confusion and uncertainty will permeate the tax field, with consequent tremendous waste of judicial and administrative time and energy. We will continue the system to which an experienced commentator referred when he wrote:

> "Meanwhile a confused Bureau and bewildered taxpayers, who would be quite content to adjust themselves to the first decision if it were left unchallenged, are forced to struggle along as best they can until the Supreme Court selects one of the available alternatives. . . ." Surrey, "Some Suggested Topics in the Field of Tax Administration", 25 Wash. U. L. Q. 399, 419.

Particularly now that the *Dobson* rule has been abrogated by statute, this Court would take an important step in carrying out its responsibility for the orderly and effective administration of justice if it would promptly recognize the grounds for granting writs of certiorari which we here urge.

If the decision below be permitted to stand, the legitimate business operations of many corporations will be open to attack. Every corporation carrying on operations with subsidiaries may find—as these taxpayers now find—that its entire system of business procedure has been overturned.

Should corporations rely on the decision below or on that of the full bench of the Tax Court? A decision of this Court would eliminate that uncertainty. Taxpayers will be able to adjust their business pro-

cedures in accordance with this Court's decision once the rule is established. But unless the decision below is now reviewed, no procedure gives any certainty or safety. This case, therefore, is of general public interest and importance.

WHEREFORE, your petitioners respectfully pray that writs of certiorari should be granted.

Respectfully submitted,

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners.

SHEARMAN & STERLING & WRIGHT
20 Exchange Place,
New York 5, N. Y.
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 151.

NATIONAL CARBIDE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 152.

AIR REDUCTION SALES COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 153.

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR THE PETITIONERS.

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners

SHEARMAN & STERLING & WRIGHT
20 Exchange Place,
New York 5, N. Y.
Of Counsel.

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OCTOBER TERM, 1948.

Nos. 151, 152, and 153.

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AIR REDUCTION SALES COMPANY,
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PURE CARBONIC, INC.,
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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR THE PETITIONERS.

I.

The Government states (Br. 14) that this Court's decision in *Moline Properties, Inc. v. Commissioner*, 319 U. S. 436, "demonstrates (pp. 440-441) that *unless the corporation is truly acting as an agent with respect to the stockholder's property*, the type of agency argument which the taxpayers here ad-

vance can not avail to make the stockholder the taxable owner of the corporation's income." (Italics ours.) Thus, the effectiveness of an agency relationship is expressly conceded.

Then, and despite the clear finding of the Tax Court, the Government repeatedly asserts that the subsidiaries were not agents. Thus (Br. 8), the Government says that: ". . . there is nothing in the record to substantiate this claim" with respect to agency. Again, on p. 9 of its brief, the Government says: "Consequently, no principal-agent relationship was created . . ."; and "Absent a true principal and agent relationship . . .". Finally, it says (Br. 16) that ". . . there is nothing in the record to support the conclusion that there was a principal-agent relationship which would suffice to make the parent the taxable owner of the income."

These statements completely disregard the record which is, in fact, full of evidence establishing the principal-agent relationship. A primary objective of the petitioners' proof through the four-day trial in the Tax Court was to show the existence of such relationship. That evidence need not be reviewed by this Court. It is fully reflected in the findings of the Tax Court, which is charged with the determination of fact matters in tax cases.

On the basis of all the evidence the Tax Court found (R. A., 28):

> "Petitioners were the corporate agents of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six per

> rent. of petitioners' outstanding capital stock belonged to and was the income and property of Airco as principal."

Moreover, the Circuit Court of Appeals did not disagree with this finding nor did it decide that there is no evidence in the record to support it. On the contrary, in its recent decision in *Railway Express Agency, Inc.* v. *Commissioner*, 168 F. 2d. ——, decided July 19, 1948, after the present petition was filed, the court below, referring to the present case, specifically pointed out:

> "So, too, it should be noted that there the subsidiaries were employed by the parent company *as its agents.*" (Italics ours.)

Thus, the Tax Court and the Circuit Court of Appeals are agreed that this is a true case of agency. The Government's effort to ignore the evidence and the findings, all of which are fully supported by the record, shows the weakness of its position.

The Government seeks subtly to convey that this case involves an attempt improperly to evade taxes. Thus, it refers to an " 'agency' device" (Br. 5), "self-styled agents" (Br. 9), and to a "contractual device" (Br. 10). This is wholly unwarranted.

The agency contracts were not some clever documentary scheme for purposes of tax evasion. As the record thoroughly establishes, they originated in reasons of practical business policy and were: of many years standing; always consistently adhered to; and always fully disclosed to the Government and to the Commissioner. Moreover, that they were justifiable

and reasonable appears from these facts, among others, that Airco furnished to the subsidiaries all assets, working capital, and all other instrumentalities used in the production of income.

Indeed, this form of corporate organization had no tendency to save taxes. It would not have resulted in any claim of tax liability here except for the fortuitous operation of the so-called declared value excess profits tax. See pp. 6-7 of the Petition.

II.

The Government points out at length that the actual facts in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, were not the same as those in the present case. But, no cases have identical facts.

The important point is that the full bench of the Tax Court regarded *Southern Pacific Co.* v. *Lowe* as establishing a principle which is applicable and controlling in this case, and that the court below reached a diametrically opposed conclusion as to the controlling validity of that case.

In its brief, the Government says (Br. 11):

> "The issue in the present case is whether a subsidiary, *regardless of the affinity between it and its parent corporation*, can escape being taxed on the income which it earns." (Italics ours.)

This amounts to an assertion that so far as tax consequences are concerned, the relationship of principal and agent can never effectively exist between a

parent and subsidiary corporation. This position is not merely contrary to the Government's own concession (Br. 14), to which reference has already been made, *supra*, pp. 1-2, but is in the teeth of the decision in *Southern Pacific Co.* v. *Lowe*. In that case this Court held that the subsidiary acted as "agent" of the parent (*Peabody* v. *Eisner*, 247 U. S. 347, 349), and gave effect to that decision. The agency relationship established here should likewise be given effect.

III.

The Government makes no reference to the public importance of a decision in this case, although every corporate taxpayer with subsidiaries must necessarily be in confusion until this Court speaks.

The full bench of the Tax Court has taken one position on an important question with respect to a decision of this Court. A Circuit Court of Appeals has taken a contrary position. But, in the absence of a decision of this Court, there is no reason why the Tax Court should not continue to follow its own view, and presumably it will do so.

Lack of finality of this sort has plagued the tax field since the creation of the Board of Tax Appeals. The problem is to find some rational and effective way for minimizing such confusion and establishing a rule so that taxpayers may know what is expected of them, and government representatives may know their duty. The obvious and natural solution is for this Court to review a decision where a Circuit Court of Appeals is in direct conflict with the full bench of the Tax Court, and the conflict involves a clear disagreement

with respect to the application of a leading decision of this Court.

The petitioners respectfully pray that writs of certiorari be granted.

Respectfully submitted,

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners.

SHEARMAN & STERLING & WRIGHT
20 Exchange Place,
New York 5, N. Y.
Of Counsel.

August 19, 1948.

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BRIEF FOR PETITIONERS.

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners

SHEARMAN & STERLING & WRIGHT
20 Exchange Place
New York 5, N. Y.
Of Counsel

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

Nos. 151, 152, and 153.

NATIONAL CARBIDE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AIR REDUCTION SALES COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONERS.

Statement.

This is a review on writs of certiorari of the decision and judgments of the United States Circuit Court of Appeals for the Second Circuit which reversed the decisions and orders of The Tax Court of the United States in these proceedings.

The Tax Court, thirteen of the sixteen judges concurring, had set aside determinations by the

Commissioner of Internal Revenue of deficiencies aggregating $1,066,253.10 in the 1938 corporation income and declared value excess profits taxes of petitioners.

Opinions Below.

The opinion of the Circuit Court of Appeals (R. 274-280) is reported in 167 F. (2d) 304.

The findings of fact and opinion of the Tax Court (R. 6-35) are reported in 8 T. C. 594.

Jurisdiction.

A petition for writs of certiorari was filed on July 14, 1948 (R. 290) and was granted by orders of this Court entered October 11, 1948 (R. 289).

The jurisdiction of this Court rests on Section 240 of the Judicial Code as amended by the Act of February 13, 1925, now Section 1254 of Title 28, United States Code.

Questions Presented.

The questions presented are as follows:

1. Where no question of "sham" or of "disregard of corporate entities" is involved, may a subsidiary corporation be the agent of its parent so that the income from its operations is properly taxable to the parent, as the Tax Court has held?

2. Should legal effect be given to express agency contracts between subsidiaries and their parent, which were always followed in all respects in all operations between them?

3. Whether this Court's decision in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, "still stands", as decided by the Tax Court, or is "no longer controlling", as decided by the court below?

4. Can a Circuit Court of Appeals properly reverse a decision of the full bench of the Tax Court in which the Tax Court expressly found and held that subsidiaries "were corporate agents" of their parent, and that the income from their operations "belonged to and was the income and property" of the parent "as principal"?

Statutes and Regulations Involved.

These cases do not involve the construction or application of any specific statutes or regulations bearing directly on the issues.

Summary Statement of Facts.

The facts found by the Tax Court (R. 6-28) establishing the agency relationship between the petitioners and their parent, may be summarized as follows:

Each of the three petitioners was a wholly owned subsidiary of Air Reduction Company, Incorporated, commonly known and herein sometimes referred to as "Airco" (R. 8). Airco, the parent company, was engaged in the manufacture of gases and also of equipment for gas and electric-arc welding, cutting and heat treatments of metals. It utilized the three petitioners in three related branches of its business (R. 8-9, 12, 21).

The Agency Contracts.

With each subsidiary, Airco had an operating contract which expressly provided that the subsidiary was employed by Airco "as its agent." These contracts follow the pattern established on March 1, 1917 in the contract between Airco and Air Reduction Sales Company (R. 13, 21).

In each contract Airco agreed to give each subsidiary the use of all gas cylinders and containers, trucks, equipment and shipping facilities which it owned; to supply each subsidiary with working capital; and to provide executive management and office accommodations and facilities for each (R. 13, 16-17, 18-19).

All assets held and used by the three subsidiaries were furnished to them by Airco which had paid for them with its own cash or by exchange for Airco's stock. All working capital was supplied by Airco (R. 22, 21).

In consideration of Airco furnishing these assets and services, each contract provided, among other things, that the subsidiary should "credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to six per cent. (6%) per annum of its outstanding capital stock" (R. 14, 17, 19).

Some of the salient facts found by the Tax Court, in addition to those relating to the operating contracts, which establish that the business of Airco was conducted through its subsidiaries as agents, were:

Board of Directors.

The Airco Board held regular meetings, determined the general policies, and completely controlled the business of Airco and each subsidiary (R. 28, 23).

Directors of the subsidiaries, with one minor exception, were all senior officers of Airco. These Boards held an organization meeting each year and thereafter met only to formalize action taken by the Airco Board (R. 22, 28).

Officers.

The officers of the subsidiaries were the officers of Airco and they exercised complete control and management over the business of each of the subsidiaries in accordance with the policies and directions of the Airco Board (R. 22, 23). Airco maintained one general office in New York for all companies (R. 21, 23).

Branches of the Business.

The business of Airco and the subsidiary companies was divided into six main branches, each headed by an officer of Airco. These branches were: Corporate, Operations, Sales, Financial, Distribution and Research. All employees in these branches performed their duties whenever and wherever required in connection with the operations of all companies (R. 23-28).

Appropriations and Purchases.

Expenditures for any company between $50 and $500 required the approval of an executive officer of Airco and those in excess of $500 required the specific approval of Airco's Board of Directors and its Chairman (R. 25).

Products produced by or materials purchased for one subsidiary were often transferred to another subsidiary and, where this was done, the transfer was reflected on inter-company accounts at cost without the transfer of any cash (R. 25).

Bank Accounts.

Bank accounts in the names of the subsidiaries were drawn upon by Airco indiscriminately whenever cash was needed for its own use or for any subsidiary no matter in whose name the account was kept (R. 25-26). There was substantial identity of officers authorized to sign checks on all accounts (R. 26).

Accounting.

All accounts were kept strictly in accordance with the operating contracts (R. 27). The value of all assets held and used by each subsidiary, all working capital furnished to it and the net proceeds from its operations in excess of its compensation under its contract, were credited to the accounts payable by the subsidiary to Airco and were debited to the accounts receivable by Airco from the subsidiary. No interest ran on any of these accounts (R. 21-22, 27).

There were no inter-company profits (R. 25, 32). None of the subsidiaries declared dividends (R. 32, 27).

Tax Returns.

During 1938, as in prior years, Airco reported as its own all income from its operations through the subsidiaries, in excess of the amount of each subsidiary's contract compensation, and paid taxes thereon accordingly (R. 11-12). Airco also declared a capital stock value of $72,981,000 for the year ended June 30, 1938 and paid a capital stock tax of $72,981. Airco's 1938 income tax return showed no declared value excess profits tax liability because 10% of the declared value ($7,298,100) exceeded its adjusted net income of $4,227,295.09 (R. 12).

Petitioners, as in prior years, declared values for their capital stock, paid capital stock taxes thereon, and paid income taxes upon the respective amounts of their contract compensation (R. 9-11).

The method by which Airco conducted its business and all details of the relationships between it and its subsidiaries were always fully disclosed to the Government and to the Commissioner (R. 28).

Adjustments Made by the Commissioner.

In 1938, for the first time, the Commissioner disregarded the operating contracts and long established pattern of Airco's operation, eliminated from Airco's return the amounts credited to Airco on the books of each subsidiary and increased the income reported by the three subsidiaries by these amounts.

The Commissioner then apportioned expenses of Airco ($415,000) between Airco and the subsidiaries. However, the Commissioner erred even in applying his own theory in that he did not make any such allocation of the deduction of $7,298,100, representing ten per cent of the declared value of Airco's capital stock used in computing its declared value excess profits tax liability (R. 6-8, 38-42).

The result was a large deficiency, which is in net effect almost wholly one of Declared Value Excess Profits Tax, resulting from attributing substantial incomes to the subsidiaries while giving them no benefit from the capital stock tax declaration of the parent.

If Airco had known that the Commissioner would change his position and refuse to accept for 1938 and later years Airco's method of reporting income, which he had accepted in prior years, Airco could properly

have made different capital stock declarations for itself and its subsidiaries, thus removing any possibility of a claim for Declared Value Excess Profits Taxes.

Decision of the Tax Court.

In the Tax Court the proceedings were tried before Honorable Eugene Black and reviewed by the entire court. Thirteen judges concurred in the decision; only three dissented and they without opinion.

The Tax Court stated that the issue before it was:

> ". . . Whether, as the respondent has determined, the income from the operations of the three petitioners belonged not to Airco, the parent, but to the petitioners and was taxable to them; or whether, as the three petitioners contend, the income from the operations of the petitioners in 1938, exclusive of the small amounts paid to petitioners under the contracts, belonged and was taxable to Airco, the parent company, both because the petitioners were in fact incorporated departments, divisions or branches of Airco's business and because the petitioners operated pursuant to express contract with Airco" (R. 29).

On all the evidence, the Tax Court's finding of ultimate fact was that:

> "Petitioners were the *corporate agents* of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six per cent of petitioners' outstanding capital stock belonged to and was the income and property of Airco *as principal*" (R. 28; italics ours).

Therefore, the Tax Court held: "That there are no deficiencies in income tax and declared value excess profits tax for the calendar year 1938" (R. 4, 5).

Decision of the Circuit Court of Appeals.

The Circuit Court of Appeals refused, however, to accord any tax consequence to the principal-agent relationship found as a fact by the Tax Court, saying:

> "'Airco' found it more convenient in its manufacture and distribution to adopt a quadripartite form than to deal directly with third persons itself. Whatever its reasons, they were business reasons, and the corporations it used were 'corporations' within any interpretation of the law. That is enough; it must accept the consequences of that choice; and it is not material that it retained the direction of their affairs down to the minutest detail, that it provided them with their assets, that it stood back of their liabilities and took all of their profits" (R. 279).

The Tax Court had cited *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, as "aptly descriptive of the relationship" between petitioners and Airco (R. 30). But the Circuit Court of Appeals, after discussing *Moline Properties, Inc.* v. *Commissioner,* 319 U. S. 436, said:

> "Even though *Southern Pacific Co.* v. *Lowe, supra,* set up a different test, we regard it as *pro tanto* no longer controlling" (R. 279).

The Circuit Court of Appeals refused to hold that the proceeds from the operations of the subsidiaries payable to Airco was the income of Airco. On petition for rehearing the petitioners then urged that these proceeds should, in view of that finding, be held

to be deductible expenses of the subsidiaries (R. 284-7). But the Court denied the petition without opinion (R. 288).

Specification of Errors to Be Urged.

The Circuit Court of Appeals erred:

1. In holding that a subsidiary corporation cannot be the agent of its parent so that the income from the operations of the subsidiary is in law, as well as in fact, the income of the parent.

2. In failing to give legal effect to clear and bona fide operating contracts between the subsidiary corporations and their parent under which the subsidiaries became agents of their parent, and in failing to hold that the amounts payable to the parent under the contracts are the income of the parent, as principal, taxable to it.

3. In holding the decision of this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, to be "*pro tanto* no longer controlling".

4. In failing to hold, if the income is to be treated as belonging to the subsidiaries, that amounts payable by the subsidiaries to Airco pursuant to bona fide operating contracts were deductible as ordinary and necessary business expenses of the subsidiaries.

5. In exceeding its powers of review by reversing the Tax Court which had expressly found and held that the subsidiaries were "the corporate agents" of their parent and that the income from the operations of the subsidiaries "belonged to and was the income and property of Airco as principal".

Summary of Argument.

I.

Corporations are separate juristic persons, and they are normally so treated for tax purposes. Mere ownership by one corporation of all the stock of a subsidiary does not of itself merge the two corporations or create the relationship between them of principal and agent.

However, this Court has unmistakably indicated that where, as here, there is either "an actual contract of agency" or "the usual incidents of an agency relationship", between a parent and its subsidiary, the income produced through the operations of the subsidiary is the income of the parent, as principal. In *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, it recognized and gave effect to that agency principle. That case has never been overruled, and in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436 and *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, this Court clearly intended to preserve its applicability in the field of agency.

The proof received in this case, at a four day trial, overwhelmingly established the existence of the principal-agent relationship between Airco and its subsidiaries. On the basis of this evidence, the Tax Court found that the subsidiaries were "the corporate agents of Airco" and "were operated as incorporated branches or divisions of Airco", and that the income from the operations of the subsidiaries in excess of their agreed agency compensation "was the income and property of Airco as principal". Moreover, the Circuit Court of Appeals did not dispute that finding.

On the contrary, in its decision in *Railway Express Agency, Inc.* v. *Commissioner,* 169 Fed. (2d) 193, it expressly confirmed that it regarded the subsidiaries, in the present case, as the corporate "agents" of Airco.

Therefore, the Circuit Court of Appeals erred in failing to hold, with the Tax Court, that the income earned through the subsidiaries was taxable to Airco and not to the subsidiaries.

II.

The Circuit Court of Appeals held that each subsidiary was a separate corporation, and regarded each as an agent of Airco. Also, it accepted the contracts under which Airco furnished to the subsidiaries, all assets, working capital and all other instrumentalities used in the production of income as bona fide operating contracts. Nevertheless, it held that the amounts payable under the contracts to Airco by the subsidiaries, belonged and were taxable to the subsidiaries, and refused to give effect to the finding of the Tax Court that these amounts were the income of Airco.

In this event, however, the Circuit Court of Appeals should have held that the amounts so payable were deductible by the subsidiaries as ordinary and necessary expenses of their business. Section 23(a) Revenue Act of 1938; *Interstate Transit Lines* v. *Commissioner, supra; Custom Casing Co., Inc.* v. *Commissioner,* 2 T. C. M. 58 (1943).

III.

The Circuit Court of Appeals was bound by the finding of the Tax Court that the principal-agent relationship existed and that the income from the opera-

tions of the subsidiaries, apart from their agency compensation, was the income of Airco. The question of the ownership of income arising out of inter-corporate relationships and operations basically presents factual issues. Whether an agency relationship existed between Airco and its subsidiaries and whether Airco or its subsidiaries were the true "economic earners" of the income were essentially questions of fact.

If this case be regarded as coming under the *Dobson* Rule, which was still in effect at the time of the Circuit Court of Appeals' decision, then surely it involved a matter of "proper tax accounting", and the Tax Court's determination should have been accorded finality.

If, however, it should be deemed governed by the principles of review applicable since the abrogation of the *Dobson* Rule the finding of the Tax Court should nevertheless be accorded finality. Rule 52(a) R. C. P.; *United States* v. *United States Gypsum Co.*, 333 U. S. 364. For the Circuit Court of Appeals did not disagree with the Tax Court's finding that the principal-agent relationship existed. Nor did it hold that there was no evidence to support that finding or that the finding was in any degree erroneous. On the contrary, it affirmatively pointed out that Airco employed the subsidiaries "as its agents".

Therefore, whether this case be regarded as coming under the *Dobson* Rule or under the scope of review applicable before that rule or presently applicable, the decision of the Circuit Court of Appeals was erroneous in that the Court exceeded its powers of review.

Argument.

POINT FIRST.

The subsidiary corporations were the agents of Airco so that the income from their operations was in law, as well as in fact, the income of Airco, as principal, taxable to it, and not to its subsidiaries.

I.

The Tax Court sustained the validity of the agency contracts between Airco and its subsidiaries, pointing out: that the policy of operating under these contracts originated in 1917; that each contract has remained unchanged and in full force from its inception down to the present time; that the method by which Airco conducted its business through corporate agencies was consistently adhered to; and that all details of the relationship between Airco and each of these subsidiaries was fully disclosed to the Government and the Commissioner (R. 13, 21, 28).

As the record thoroughly establishes, the agency contracts were business arrangements representing the actual relationships between the corporations. Moreover, they were justifiable and reasonable as appears from these facts, among others: that Airco furnished to the subsidiaries all assets, working capital, and all other instrumentalities used in the production of income. The contracts were not some clever documentary scheme for purposes of tax evasion.

The record is full of evidence establishing the principal-agent relationship. This Court need not review that evidence. It is fully reflected in the findings of the Tax Court charged with the determination of fact matters in tax cases.

On the basis of all the evidence the Tax Court found (R. 28):

> "Petitioners were the *corporate agents* of Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of six per cent. of petitioners' outstanding capital stock belonged to and was the income and property of Airco *as principal*." (Italics ours.)

Moreover, the Circuit Court of Appeals did not disagree with this finding nor decide that there is no evidence to support it. On the contrary, in its recent decision in *Railway Express Agency, Inc.* v. *Commissioner,* 169 Fed. (2d) 193, decided July 19, 1948, the Circuit Court of Appeals, referring to this case, specifically pointed out:

> "So, too, it should be noted that there the subsidiaries were employed by the parent Company *as its agents*" (p. 196; italics ours).

Thus, the Tax Court and the Circuit Court of Appeals are agreed that in this case the subsidiaries were the agents of their parent Airco. But the Circuit Court of Appeals unlike the Tax Court accorded that fact no tax consequence.

II.

The Tax Court cited *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, as "aptly descriptive of the relationship which existed between petitioners and their parent Airco in the instant case." The issue in that case was not the same as here. But, the factual relationship there was similar to that in the present

case, and the decision is important because this Court there recognized and gave effect to the agency principle for which we contend. In that case, as in ours, control of the subsidiary by the parent was so complete that this Court found, as a matter of fact, that the subsidiary was merely *an agent* of the parent.

In 1914 the subsidiary had declared dividends and paid them out of surplus accrued prior to March 1, 1913. The payment was carried into effect by bookkeeping entries. The question was whether the dividends thus received by the parent were taxable as income to the parent in 1914.

This Court held that the payments were not taxable to the parent because the parent and the subsidiary were in substance identical, saying (p. 337):

> "While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, *acting merely as its agent* and subject in all things to its proper direction and control." (Italics ours.)*

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* In *Peabody* v. *Eisner*, 247 U. S. 347, decided the same day as the *Southern Pacific* case, this Court said, at page 349:

> ". . . *Southern Pacific Co.* v. *Lowe*, has been reversed this day, *ante*, 330, but only upon the ground that the Central Pacific Railway Company which paid the dividend, and the Southern Pacific Company, which received it, were in substance identical corporations because of the complete ownership and control which the latter possessed over the former as stockholder and in other capacities, so that while the two companies were separate legal entities, yet in fact and for all practical purposes the former was but a part of the latter, acting merely as its agent and subject in all things to its direction and control; and for the further reason that the funds represented by the dividend were in the actual possession and control of the Southern Pacific Company as well before as after the declaration of the dividend."

The present case is also one of agency, as the Tax Court found. After quoting the above language from *Southern Pacific* v. *Lowe*, the Tax Court said (R. 30):

> "We think the foregoing words of the Supreme Court are aptly descriptive of the relationship which existed between petitioners and their parent, Airco, in the instant case."

A little later it said (R. 32):

> ". . . We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra.*"

Finally, the Tax Court referred to the fact that the Commissioner had accepted returns from the taxpayers for the years 1935, 1936 and 1937, on the basis for which they now contend, and concluded (R. 35):

> ". . . Nevertheless, we think that his apparent interpretation of the law in 1935, 1936, and 1937 as it affected petitioners was correct and that the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra,* still stands."

It is clear, therefore, that the full bench of the Tax Court regards *Southern Pacific Co.* v. *Lowe* as still law in cases of agency, and that it considered the present case to be a clear case of agency. But, the Circuit Court of Appeals has refused to recognize the effect of an actual agency relationship although this Court did recognize it in the *Southern Pacific* case. The Circuit Court of Appeals regarded the *Southern Pacific* decision as one which this Court "is not willing any longer to treat as authoritative", and held that it is "no longer controlling" (R. 277, 279).

On the contrary, the continuing validity of the

Southern Pacific case within the field of actual agency relationship has been recognized by this Court in recent decisions. Thus, in *Moline Properties, Inc.* v. *Commissioner*, 319 U. S. 436, which was heavily relied upon by the Court below although its facts were wholly dissimilar, this Court had expressly pointed out (p. 440):

> ". . . There was no actual contract of agency nor the usual incidents of an agency relationship."

In the *Moline* case this Court clearly recognized the principle that tax consequences do flow from the principal-agent relationship. But it refused to apply that principle because the facts did not establish the existence of that relationship.

Moline was organized by Thompson, its sole stockholder, at the suggestion of a bank, to protect a second mortgage held by the bank on four lots owned by Thompson and to secure an additional loan. Sometime later when the loan had been discharged, Moline sought to have the gain on sales of its real property treated as the gain of Thompson.

But, on the particular facts, this Court held that the gains were taxable to Moline, pointing out: that from its inception Moline had a special function; that it was "clearly not Thompson's *alter ego*"; that "his exercise of control over it was negligible"; that there was no "actual contract of agency, nor the usual incidents of an agency relationship"; that on the facts before the Court Moline "had a tax identity distinct from its stockholder"; and therefore that the capital gains belonged and were taxable to Moline and not to Thompson.

In the present case there are contracts of agency; all the usual incidents of agency relationship are

present; and the Tax Court expressly found and the Circuit Court of Appeals in the *Railway Express Agency* case confirmed, that the petitioners were the corporate agents of Airco (*supra*, p. 15).

Likewise, in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, this Court said (p. 593):

> "This is not the case of a mere branch or division of a business conducted solely for convenience's sake under a separate corporate form."

Thereby, this Court pointed to the absence, in that case, of an important relationship, present in this case, in which the Tax Court has expressly found that the "Petitioners . . . were operated as incorporated branches or divisions of Airco" (R. 28).

In the *Interstate Transit* case, the petitioner, Interstate, a foreign corporation, operated an interstate bus line between Illinois and California and Missouri and Wyoming. Under California law, prior to 1937, Interstate, being a foreign corporation, was prohibited from doing an intrastate business in California.

To handle such intrastate business on its buses, Interstate organized a California bus corporation referred to as "Stages". It made an agreement with Stages that Stages would take over the operation of Interstate's buses at the state line and operate them in California for Interstate's benefit and under its direction, the profits to be paid to Interstate and any deficit to be borne by it.

In 1936, Stages had an operating deficit which Interstate paid, pursuant to its agreement, and deducted as an expense of its own business. The decision of the

majority of this Court disallowing the deduction was placed squarely upon the ground that Stages was engaged in a business which Interstate could not lawfully do, hence that Interstate could not claim the deduction.

In that case, however, in both prevailing and minority opinions, this Court again recognized that a bona fide operating contract between a parent and a subsidiary may have tax consequences. The decision of the majority, through Mr. Justice Reed, assumed the validity of the contract, and disallowed the claimed deduction only upon the ground that the subsidiary was engaged in an intrastate business which Interstate could not legally do.

However, the majority opinion indicated unmistakably that if the record before the Court had segregated the interstate business which Stages could "legally" do, for Interstate, from the intrastate business which Stages could not "legally" do, for Interstate, the allowance to Interstate of that portion of the claimed deduction attributable to such "legal" business would have been approved pursuant to the contract between them (pp. 593-4).

Mr. Justice Jackson, however, in his dissenting opinion (Chief Justice Stone and Mr. Justice Murphy concurring) called the arrangement and the contract between the two corporations a "commonsense business arrangement", and they were of the opinion that the deduction was allowable in any event.

Thus, the decision of the Circuit Court of Appeals in the present case erroneously rejects *Southern Pacific* v. *Lowe*, and applies recent decisions of this

Court to a factual situation which was expressly excepted in those recent decisions. *Southern Pacific Co.* v. *Lowe*, has never been overruled and this Court in its opinions in the *Moline Properties* and *Interstate Transit* cases undoubtedly intended to preserve its applicability in the field of agency. It unmistakably indicated that where there is either "an actual contract of agency" or "the usual incidents of an agency relationship", the income produced through the operations of the agency company is the income of the parent, as principal.

POINT SECOND.

The Circuit Court of Appeals erred in failing to hold, that if the income is to be treated as belonging to the subsidiaries, the amounts payable by the subsidiaries to Airco were deductible as ordinary and necessary business expenses of the subsidiaries.

I.

The Circuit Court of Appeals held that each subsidiary was a separate corporation "within any interpretation of the law", although it regarded each subsidiary as an agent of Airco (*supra*, pp. 9, 15). Further, it accepted the contracts under which Airco furnished to the subsidiaries all assets, working capital and all other instrumentalities used in the production of income, as bona fide operating contracts. Nevertheless, the Court failed to hold that the amounts payable under the contracts to Airco, by the subsidiaries, in consideration, were the income of Airco.

The Circuit Court of Appeals having refused to hold that the amounts so payable were the income of Airco,

we submit that it was faced with the inescapable alternative of holding that these amounts were necessary business expenses of the subsidiaries, deductible as such by them. That contention was implicit in the position of the taxpayers and was squarely presented to the Court on petition for rehearing; but the Court denied the petition without opinion, refusing to accord to the contracts any legal effect whatsoever (R. 284-288).

That the Circuit Court of Appeals should, in the alternative, have held that the amounts so payable to Airco were deductible by the subsidiaries as ordinary and necessary expenses of their business seems unquestionable. *Section 23(a) Revenue Act of 1938.**

Thus, in the *Interstate Transit Lines* case, *supra*, pp. 19-20, the majority of this Court held that the expense there involved was not a "rightful deduction under Section 23(a)" only because the intrastate business of Stages could not properly be regarded as Interstate's business, since Interstate, itself, could not legally do intrastate business in California (p. 594). But, the implication of the majority opinion is clear that, but for that exceptional circumstance, the expense would have been deductible as an obligation of Interstate under its contract with Stages. The minority opinion, on the other hand, gave full legal effect to the contract and concluded that the inability of Interstate legally to do intrastate business in

* "Sec. 23 Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

"(a) Expenses. All the ordinary and necessary expenses paid or incur during the taxable year in carrying on any trade or business. "

California was not a valid ground for the disallowance of the claimed deduction.

More than four years before the Tax Court decided the present cases, it decided *Custom Casing Co., Inc. v. Commissioner of Internal Revenue*, 2 T. C. M. 58 (1943). That case, strikingly similar to this on the facts, also involved express agency contracts between a parent and its subsidiaries with all the usual incidents of agency operation. It too raised the question whether income from operations of the subsidiaries belonged to the parent. The Tax Court there held, as it did in the present case, that the income belonged to the parent. But, in the course of its opinion the Court considered also whether the inter-company agency contracts could give rise to a deductible business expense, and concluded (p. 76):

> ". . . if we consider the subsidiary-agents as separate corporate entities, we must give effect to the agency contracts executed between them and Hygrade and come to the conclusion indicated above: that Hygrade is . . . entitled to deduct any losses incurred by the subsidiary-agents pursuant to the agency contract which Hygrade was obligated to pay and which, in fact, it did pay."

II.

The "contention" that the amounts payable to Airco should, in the alternative, have been held to be deductible expenses of the subsidiaries was inherent in the issue presented in the Tax Court, and was never waived (R. 34).

The Commissioner had held that all income produced by the operations of the subsidiaries belonged to them and not to Airco. He also apportioned to

each subsidiary such part of the total expenses paid or accrued by Airco ($415,000) as he deemed attributable to the operations of each subsidiary. In response to an inquiry of the Court, counsel for petitioners agreed that there was then no controversy regarding the "amount of income" and the "amount of expenses" which the Commissioner, on his theory, had thrown back to the subsidiaries (R. 183). The expenses referred to were obviously the allocated expenses of Airco and not the amounts payable *by the subsidiaries* to Airco under their contracts.

No concession was made which would preclude the contention that if the amounts payable by the subsidiaries to Airco under their contracts are held not to be the income of Airco, then those amounts are deductible business expenses of the subsidiaries. The Tax Court, therefore, went beyond the scope of petitioners' concession when it stated that they "concede that if the issue which is raised by the pleadings is decided against them, then the deficiencies are those which have been determined by respondent" (R. 34).

III.

The issue in the Tax Court, as expressed, was whether the amounts payable to Airco are taxable to Airco as its "income" or taxable to the subsidiaries as their "income" (R. 29, 34). But, the underlying question was: should the obligations of the subsidiaries arising out of the contracts and out of the agency relationship be given any legal effect for tax purposes? The Circuit Court of Appeals erred, we submit, in according those obligations no legal effect, whether viewed as involving amounts payable as income to Airco or as amounts payable as expenses of the subsidiaries.

POINT THIRD.

The Circuit Court of Appeals was bound by the finding of the Tax Court that the principal-agent relationship existed and that the income from the operations of the subsidiaries, apart from agency compensation, was the income of Airco.

In reversing the Tax Court the Circuit Court of Appeals exceeded its powers of review.

The Tax Court recognized that the question of the ownership of income arising out of inter-corporate relationships and operations basically presents factual issues; and that the business of a subsidiary can be so directed, managed and controlled by its parent that the subsidiary constitutes, as a matter of fact, a mere incorporated branch, division, department or agent of the parent. Also, the Tax Court recognized that one corporation may be the contractual agent of another.

Further, the Tax Court was of the opinion that if either of these situations exists, the income derived from the operations of the subsidiary, is, in fact, the income of the parent as principal. In either, the parent is the "economic earner" of the income.

The issue below was the ownership of income, which was dependent upon whether an agency relationship existed between the subsidiaries and Airco. That issue was basically one of fact. The case was tried at length before the Tax Court, and it expressly found upon overwhelming evidence that "Petitioners were the corporate agents of Airco", and that "the income from the operations of petitioners . . . belonged to and was the income and property of Airco as principal" (R. 28).

At the time this case was decided by the Circuit Court of Appeals, the decision of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489, was in effect. It has since been abrogated by the amendment to Section 1141(a) of the Internal Revenue Code which was made by Section 36 of the Act of June 25, 1948.*

Under the *Dobson* rule, which was then applicable, we believe it entirely clear that the findings of fact and decision of the Tax Court should not have been interfered with by the Circuit Court of Appeals. This case is surely one of "proper tax accounting" (*Dobson* v. *Commissioner*, *supra*, at pages 501-2).

The same conclusion follows, however, under the statute as it has now been amended. That statute directs that the Circuit Courts of Appeals shall have the same power in reviewing decisions of the Tax Court as in reviewing "decisions of the district courts in civil actions tried without a jury".

Rule 52(a) of the Rules of Civil Procedure deals with findings by a district court, in a case tried without a jury. With reference to that rule this Court recently said in *United States* v. *United States Gypsum Co.*, 333 U. S. 364, at pages 394-5:

> "'. . . In so far as this finding and others to which we shall refer are inferences drawn from documents or undisputed facts, heretofore described or set out, Rule 52(a) of the Rules of Civil Procedure is applicable. That rule prescribes that findings of fact in actions tried with-

* The section, as amended effective September 1, 1948, reads as follows: "The Circuit Courts of Appeals . . . shall have exclusive jurisdiction to review the decisions of the Tax Court . . . in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; . . ." (Public Law No. 773, 80th Congress, 2nd Session).

out a jury '*shall not be set aside unless clearly erroneous,* and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.' . . . A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." (Italics ours.)

But the Circuit Court of Appeals did not disagree with the Tax Court's finding that the principal-agent relationship existed. Nor did it hold that there was no evidence to support that finding or that it was, in any degree, erroneous. Indeed, as we have shown, the Circuit Court of Appeals, itself, affirmatively pointed out that Airco employed the subsidiaries as its agents (*supra*, p. 15).

Long before its decision in the *Dobson* case this Court had established the rules for review of actions at law tried by a district court without a jury. For example, in *McCaughn* v. *Real Estate Land Title & Trust Co.*, 297 U. S. 606, this Court held that a Circuit Court of Appeals was without authority to reverse a decision of a district court on the issue of contemplation of death. It said, page 608:

> ". . . The ultimate question for the decision of the trial court was one of fact and its general verdict was conclusive. The Circuit Court of Appeals was without authority to weigh the evidence and to make its own findings."

Similarly, prior to the *Dobson* decision, this Court had established the rules for review of decisions of the Board of Tax Appeals. In *Wilmington Trust Co.*

v. *Helvering,* 316 U. S. 164, where the issue before the Board was whether certain sales were short sales or ordinary sales, this Court reversed the Circuit Court of Appeals, which had reversed the Board. It said at page 168:

> "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences. The Court may not substitute its view of the facts for that of the Board. Where the findings of the Board are supported by substantial evidence they are conclusive."

Therefore, whether this case is regarded as coming under the *Dobson* rule or under the scope of review applicable before that rule or presently applicable, the decision of the Circuit Court of Appeals was erroneous in that the Court exceeded its powers of review. The finding of the Tax Court that the income from the operations of the subsidiaries was the income of Airco as principal should have been accepted as conclusive by the Circuit Court of Appeals.

CONCLUSION.

The decision of the Circuit Court of Appeals should be reversed and the decisions of the Tax Court of the United States should be reinstated.

The decisions of the Tax Court are clearly supported by the proof that Airco not only created the income but is the only party having a beneficial interest in the income and the right to receive and enjoy it.

The decision of the Circuit Court of Appeals is founded upon a strained and unrealistic construction

of long established and always fully disclosed business relationships. It defeats the primary purpose of the income tax laws—to obtain revenue from the real owner of income. Such disregard of factual realities should not be approved.

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners.

SHEARMAN & STERLING & WRIGHT
20 Exchange Place,
New York 5, N. Y.
Of Counsel.

November 23, 1948.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 151.

NATIONAL CARBIDE CORPORATION, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 152.

AIR REDUCTION SALES COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

No. 153.

PURE CARBONIC, INC., *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR THE PETITIONERS.

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners

SHEARMAN & STERLING & WRIGHT
20 Exchange Place
New York 5, N. Y.
Of Counsel

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PURE CARBONIC, INC.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

REPLY BRIEF FOR THE PETITIONERS.

I.

Applicable legal principle is undisputed.

The parties appear to be agreed as to the applicable law. Petitioners concur in the following statement of legal principle set forth in the Government's brief (p. 45):

> "The Commissioner does not at all negate the proposition that where a principal-agent relation-

ship exists, the principal's income is taxable to him, not to the agent, even though the money may pass through the agent's hands when collected by him for transmission to his principal. Nor is it denied that, in proper circumstances, a principal-agent relationship may exist between related corporations as it may between members of a family."

Specifically, the Government seems to concede (Br. 47) that "if the subsidiaries were acting as agents" of their parent, Airco, "the profits of the business were truly those of the parent as principal."

II.

The Courts below found the principal-agent relationship established.

The Government asserts (Br. 11): "There are no facts in this case which would permit the conclusion that the taxpayers were acting *as agents* for their stockholder, the parent company. *Nor did the Tax Court decide otherwise.*" (Italics ours.) It also states that the Tax Court did not hold that this was a case of "one corporation acting as an agent for another" (Br. 40).

The justification for these and similar statements is not clear. A striking indication of the weakness of the Government's position, however, is its failure to set forth and to explain or deal with the following clear and controlling finding of the Tax Court based upon all the evidence (R. 28):

"*Petitioners were the corporate agents of*

Airco and were operated as incorporated branches or divisions of Airco. The income from the operations of petitioners which is in excess of 6 per cent of petitioners' outstanding capital stock belonged to and *was the income and property of Airco as principal.*" (Italics ours.)

Moreover, the Circuit Court of Appeals expressed no disagreement with this finding; neither did it say that there was no evidence to support it. In its opinion, it expressly recited (R. 275) the contracts by which "The parent employed the subsidiary 'as its agent to manage and operate,'" and "'as its agent to market and sell.'" It also recited (R. 276) the above quoted finding of the Tax Court that "the subsidiaries were merely 'the corporate agents of Airco'" and that the income from their operations "'belonged to and was the income and property of Airco as principal.'" The Court simply failed, we think in error, to give legal effect to those findings.

Indeed, in our main brief (p. 15) we point out that the Circuit Court of Appeals has expressly recognized that the subsidiaries "were employed by the parent company as *its agents.*" (Italics ours.) *Railway Express Agency, Inc.* v. *Commissioner*, 169 F. 2d 193, 196. But the Government now seeks to minimize the statement by saying that it was merely a "dictum" written by Judge Clark "who did not participate in the present case" (Br. 44).

Clearly, however, that was a carefully considered statement made in a case involving a closely related issue. Although the opinion in the *Railway Express Agency* case was written by Judge Clark who did not participate in the decision in our case, it was con-

curred in by Judge L. Hand who wrote the opinion in our case, and by Judge Swan who concurred in the decisions in both cases.

Further, the Government conveys the erroneous impression that the principal-agent argument was not presented to the Circuit Court of Appeals or to the Tax Court. It asserts that the taxpayers "now argue" and have "only lately invoked" the principal-agent relationship as a basis for contending that the income belonged to Airco (Br. 40, 43). Inferentially the Government suggests that our argument is belated and should not be considered here.

Petitioners did unquestionably present that argument fully both in the Tax Court and in the Circuit Court of Appeals. That it was presented to the Tax Court is reflected in the findings and opinion of that Court, and in particular in its ultimate finding that the subsidiaries "were the corporate agents of Airco" and that the income and property belonged to Airco "as principal." Of pertinence also is the official headnote to the findings and opinion, prepared by the Tax Court, which we annex hereto as Appendix A.

That the argument based upon the principal-agent relationship was also presented fully to the Circuit Court of Appeals is evidenced by extracts from the index to our brief in that Court, set out in Appendix B to this brief. There is no basis, whatsoever, for any claim of surprise or "shift of ground" in this Court.

III.

The principal-agent relationship was fully supported by evidence.

The Government repeatedly asserts that the subsidiaries were not agents, and claims we have made "no attempt to document the conclusion" that the principal-agent relationship existed (Br. 45-46). The petitioners did not burden this Court with a detailed repetition of the evidence which the Tax Court had carefully weighed and evaluated. But ample evidence does support this finding.

The provisions of the contracts set out by the Tax Court, by the Circuit Court of Appeals, and by the Government itself (Br. 6-8, 46), show that Airco employed each subsidiary "as its agent" to manage and operate plants, and "as its agent" to market and sell the output of the plants.

In addition, the Tax Court's findings and opinion (R. 6-35) refer to numerous other facts establishing the agency relationship. These facts include, among others:

> All assets held by each subsidiary were furnished to it by Airco which paid for them with its own cash or stock (R. 31, 22). Title to over 850,000 gas cylinders, one of the most essential and valuable assets, costing nearly $13,000,000, was retained by Airco, which allocated them without charge to the agency companies as required (R. 27, 18, 21). Airco supplied all the working capital of each subsidiary (R. 31, 21).

The value of all assets held by the subsidiaries, the working capital supplied to them and the net proceeds of operations in excess of agency compensation were credited to the accounts payable by the subsidiaries to Airco and debited to the accounts receivable by Airco from each agency company. No interest ran on any of these accounts (R. 21-22, 27, 32).

There was substantial identity of the directors and officers of the subsidiaries and of Airco (R. 21-22, 30-31). The Airco Board held regular meetings and exercised complete domination and control over the business of Airco and each subsidiary (R. 23, 28, 31).

There was a single general office (R. 21, 23, 31). The business of Airco and its subsidiaries was conducted as one business unit, divided into six branches, and all employees in each of the six branches performed their duties for the parent and each agency company whenever and wherever their services could be utilized (R. 23, 31).

All expenditures for each agency company in excess of $50 required the approval of an officer of Airco, and expenditures for more than $500 required the specific approval of Airco's Board and its Chairman (R. 25, 31). When products produced by, or materials purchased for, one agency company were transferred to another, the transfer was made at cost, without the passage of any cash (R. 25, 31-32). All bank accounts in the name of each subsidiary were treated by Airco as its own, being drawn upon by Airco at will (R. 26, 32).

> The proceeds realized from each agency company's activities did not come to Airco as the result of any independent action by the agency company, such as a declaration of dividends (R. 32). The agency company's accounts were cleared monthly to Airco and all accounts were kept strictly in accordance with the agency agreements (R. 27, 32).

Thus the existence of the long standing principal-agent relationship was sustained by overwhelming evidence.

The Government says that if the relation of principal-agent existed, then (Br. 47) "It would have to follow that the losses would also be those of the parent." Actually, that was the situation here, and the contracts were so construed. During 1938, Airco had four subsidiaries, the three petitioners and Wilson Welder & Metals Co., Inc. The latter subsidiary showed a loss in 1938 and is not before this Court. The findings of the Tax Court, however, show that Airco bore this loss by a charge against it and a credit in favor of Wilson Welder in the amount of $90,940.74 (R. 11).

IV.

Airco was in every real sense the owner of all assets used in the production of income.

The Government repeatedly asserts that the subsidiaries "owned" the plants, machinery and other assets with which the business was conducted and that they used those assets and "earned" the income in question (Br. 2, 10, 12, 21, 22, 23, 24, 25, 27, 28, 29, 40, 47, 48). It makes only casual acknowledgment

of the fact that Airco at all times owned all the cylinders, a major asset costing approximately $13,000,000, which were used for containing and shipping gases (Br. 24).

We have shown (*supra*, p. 5) that Airco paid for and furnished to the subsidiaries all assets, working capital and all other instrumentalities used in the production of income. In every real sense, therefore, Airco was the owner of those assets although title to much of this property stood in the names of the subsidiaries. But "title" is not "ownership". A trustee does not own the property of which he has title for the benefit of others, and he is not taxed on the income produced by its use. Similarly, as here, an agent may have title to his principal's property without really being the owner of the property and without liability for taxes on income produced by its use.*

As this Court said in *Griffiths* v. *Commissioner*, 308 U. S. 355, 357-8:

> "We cannot too often reiterate that 'taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed—the actual benefit for which the tax is paid.' *Corliss* v. *Bowers*, 281 U. S. 376, 378. And it makes no difference that such 'command' may be exercised through specific retention of legal title or the creation of a new equitable but controlled interest, or the maintenance of effective benefit through the interposition of a subservient agency. Cf. *Gregory* v. *Helvering*, 293 U. S. 465."

* Cf. *Poe* v. *Seaborn*, 282 U. S. 101 at page 109.

V.

Southern Pacific Co. v. *Lowe*—"aptly descriptive".

The Government has dealt at length with *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, pointing out in great detail that it differs on the facts from this case. But, as we have said in our main brief (pp. 15-18, 20-21) the Tax Court regarded it, and we regard it as important primarily because it is "aptly descriptive" of the relationship between Airco and its subsidiaries, and because this Court gave legal effect to the agency principle.

VI.

No sham or tax evasion device is involved.

The Government also says (Br. 50) that tax results cannot "be altered by the simple expedient of adopting nomenclatures which do not aptly describe the true legal relationships among the parties." Similarly (Br. 49), it says that "here the parties have gone through the motions of calling each other 'principal' and 'agent'." These and similar comments seem to suggest that the contracts here involved and the whole relationship between the parties were a sham. Such assertions are not based on anything in the record or in the findings or opinion of the Tax Court or of the Circuit Court of Appeals.

Nor is there any merit in the Government's attempt arbitrarily to classify the agency agreements with instruments for the anticipatory assignment of income, made for purposes of tax-evasion (Br. 10, 11, 15, 26, 27). The cases cited by the Government as authorities in this connection all involve facts radically dissimilar

from those here presented. In all, a tax evasion or avoidance purpose is present.

The operations in the present case were pursuant to contracts which originated in 1917, and which have remained unchanged and in full force from their inception to the present time. They were not a tax evasion device. The Tax Court has accepted their validity and expressly found that (R. 28):

> "The method by which Airco conducted its business through corporate agencies was consistently adhered to and all details of the relationship between Airco and each of its corporate agencies or divisions were always fully disclosed to the Government and the Commissioner."

VII.

If the subsidiaries are deemed owners of the income, then the amounts payable to Airco are deductible expenses.

The Government contends that we seek, in the alternative, to have allowed as deductions to the subsidiaries not "the expenses incurred in earning their profits", but "the very profits themselves" (Br., p. 53). We do not ask that "profits" of the subsidiaries be held deductible expenses. The amounts which the subsidiaries are obligated to pay to Airco under their contracts can in no sense be regarded as "profits". If the Court of Appeals be correct in its decision, then these amounts are payable to Airco as necessary expenses of the subsidiaries because Airco furnishes them with all assets, working capital and other instrumentalities used in the production of income.

There is surely no reason why the subsidiaries should not pay Airco for the use of these instrumentalities if the income be regarded as the income of the subsidiaries. Such payments should be deductible by the subsidiaries as wholly proper payment for the use of Airco's property. Only the agency compensation of the subsidiaries under their contracts, remaining after such payment, would be "profits" to the subsidiaries.

Next, the Government asserts we are "improperly seeking to raise a new issue on appeal" (Br. 55). This is not so. As we have pointed out in our main brief (pp. 21-24) the question of deductibility was inherent in the issue presented in the Tax Court. But since the Tax Court sustained our contention that the income belonged to Airco the question of deductibility did not there expressly arise.

The question was presented, however, to the Circuit Court of Appeals on petition for rehearing (R. 284-8) because that Court had held that the income *belonged* to the subsidiaries. Then the question of deductibility, for the first time, became pertinent.

Conclusion.

If the decision of the Circuit Court of Appeals should be affirmed and the deficiency assessments sustained, the result would be most inequitable. As we have pointed out (Main Br. 7-8) the large net deficiency, after allowance for the Commissioner's finding of an over-payment of $545,134.45 in income tax by Airco, is almost wholly one of Declared Valu. Excess Profits Tax which the taxpayers might properly have avoided.

This claimed deficiency arises from the Commissioner's sudden change of position, for the first time in 1938, after many years during which he had full knowledge of all the facts. It resulted from attributing substantial income to the subsidiaries for whom only small capital stock tax declarations had been made, and, at the same time, withholding from the subsidiaries any benefit from the large capital stock tax declaration of Airco which was more than sufficient to cover all of the income of all of the companies.

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

ERWIN N. GRISWOLD
BOYKIN C. WRIGHT
EDGAR J. GOODRICH
JOHN A. WILSON
Counsel for Petitioners

SHEARMAN & STERLING & WRIGHT
20 Exchange Place
New York 5, N. Y.
Of Counsel

January 3, 1949

APPENDIX A

Headnote in 8 T. C. 594

"THE TAX COURT OF THE UNITED STATES

NATIONAL CARBIDE CORPORATION, PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

AIR REDUCTION SALES CO., PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

PURE CARBONIC, INC., PETITIONER, v. COMMISSIONER OF INTERNAL REVENUE, RESPONDENT.

Docket Nos. 5822, 5823, 5824. Promulgated March 25, 1947

Petitioners are wholly owned subsidiaries of a parent corporation organized in 1915. During the taxable year 1938 and for many years prior thereto petitioners operated under separate contracts with the parent to act as the parent's agent in managing, operating, and selling the products from the plants turned over to them by the parent for that purpose. Under these contracts the subsidiaries agreed to credit monthly to the parent all profits accruing from the operation of such plants over and above an amount equal to 6 per cent on their outstanding capital stock, which in the case of each subsidiary was a very nominal amount. The parent agreed to furnish all the necessary working capital and to provide such

executive management as might be necessary for the proper conduct of the businesses. Petitioners were operated as branches or divisions of the parent corporation. *Held,* the income earned under each of these contracts in excess of the 6 per cent of the outstanding capital stock of each subsidiary, respectively, belonged to and was the income of the parent corporation as principal, and was not, therefore, taxable to petitioners. *Southern Pac. Co.* v. *Lowe,* 247 U. S. 330, followed. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590, distinguished."

APPENDIX B

Extracts From Index to Brief of Respondents in the United States Circuit Court of Appeals for the Second Circuit in the Case of *Commissioner of Internal Revenue* v. *National Carbide Corporation*, and Related Cases

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* * * *

"POINT ONE—The decisions of the Tax Court in these proceedings are based solely upon an ultimate finding of fact, fully supported by the evidence: That the income from the operations of the subsidiaries, apart from agency compensation, *belonged to and was the income and property of the parent as principal.*

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(Note: Italics have been added here.)

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ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. A. 5-36)[1] are reported at 8 T.C. 594.

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[1] The printed record filed in this Court consists of three parts which, although fastened together as a single volume, are separately paged. The first part will be referred to herein as

The opinion of the Circuit Court of Appeals (R. C. 1-9) is reported at 167 F. 2d 304.

JURISDICTION

The judgments of the Circuit Court of Appeals (R. C. 10, 12, 14) were entered on March 31, 1948. A petition for rehearing (R. C. 16-21) dated April 14, 1948, was denied on April 19, 1948 (R. C. 22, 24). A petition for writs of certiorari was filed on July 14, 1948.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925. Effective September 1, 1948, this will be Title 28, United States Code, Section 1254.

QUESTION PRESENTED

The taxpayers are regularly organized corporations, owning valuable assets and employing officers and employees. They manufacture products which they sell to the public at a profit. All of their stock is owned by a parent corporation, to which they have agreed to pay over all except a most nominal part of their earnings.

The question is whether the Circuit Court of Appeals was correct in holding that the taxpayers were taxable on all the income which they earned, and in reversing the Tax Court which had held

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"R.A." and consists of the Appendix to the Government's brief in the Circuit Court of Appeals. The second part will be referred to herein as "R.B." and consists of the Appendix to the taxpayers' brief in the Circuit Court of Appeals. The third part, referred to as "R.C." consists of the proceedings in the Circuit Court of Appeals.

that they were not taxable on the portion of their income which they paid over to the parent corporation pursuant to agreement.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved are set forth in the Appendix, *infra*, pp. 18-20.

STATEMENT

These proceedings involve asserted deficiencies in income and declared value excess-profits taxes for the calendar year 1938. (R. A. 5-7.) Although the Tax Court's findings of fact are extensive (R. A. 7-28), the pertinent facts may be summarized as follows:

Each of the taxpayers, possessing only a nominal capitalization, is a wholly owned subsidiary of Airco Reduction Company. (R. A. 7, 11.) They are engaged in the manufacture and sale of chemicals and chemical gases. (R. A. 7-8.)

The taxpayers own valuable assets which they employ in their business. Some of these were acquired as a result of the transfer of physical property to them from the parent company, directly or at its direction. The taxpayers showed a book indebtedness to the parent for the value of this property. Further assets were acquired as a result of direct purchases made by the taxpayers out of their earnings and out of funds advanced by the parent. They also showed a book indebtedness to the parent for the value of these assets. (R. A. 20-21.) Certain gas cylinders, however, were owned

by the parent corporation and were allocated to the various subsidiary companies as required by them. (R. A. 21.) The subsidiaries, apparently, were not charged any rental for the use of these cylinders.

During the taxable year there were in existence similar contracts between each of the taxpayers and the parent company. Pursuant to each agreement the parent purported to employ the subsidiary "as its agent" to manage and operate the plant, and to market and sell the output, the subsidiary agreeing to pay to the parent "all profits accruing to it from the operation of its entire business", except that the subsidiary was entitled to retain an amount equal to 6 percent on its outstanding capital stock (nominal in amount), which sum it agreed to accept as its compensation. (R. A. 12-13, 14-16, 17-19.) The accounts between the parent and the subsidiary were kept strictly in accordance with these agreements. (R. A. 28, 32.)

Because of its stock ownership, and by means of common directors and officers, the parent company exercised complete control over the business functions, policies, and funds of the taxpayers. It was also able to achieve a close integration of the operations and facilities of the taxpayers. (R. A. 30-32.)

In their returns for the taxable year, each of the taxpayers deducted the amount paid or credited to the parent pursuant to the agreements, thereby

reporting as income only the nominal amounts which they purported to retain as compensation for their services. The Commissioner determined deficiencies after concluding that the subsidiaries were taxable on all their income, undiminished by the amounts paid or credited to the parent. In so doing, however, he permitted a deduction for certain expenses which had been incurred by the parent company, but which the Commissioner allocated to the taxpayers under Section 45 of the Revenue Act of 1938. (R. A. 5-7.) The Tax Court refused to sustain the Commissioner's deficiency determinations, holding that the taxpayers were operated as incorporated branches or divisions and as corporate agents of the parent and that the income was owned by the parent and taxable to it. (R. 28-36.)

The Circuit Court of Appeals reversed the Tax Court. It held that since the taxpayers were separate corporations engaged in a business, they were taxable on their own earnings despite the fact that they were wholly owned subsidiaries, and despite the fact that they had attempted to deflect their earnings to the parent by means of an "agency" device. (R. C. 1-9.)

ARGUMENT

I. The decision below is correct in holding that the taxpayers, which are wholly owned subsidiaries of a common parent company, are taxable on the separate incomes which they earned. Each taxpayer is a distinct, regularly organized corporation

carrying on a business. Each, as a corporation, in the conduct of its business, owns and controls assets of considerable magnitude. Thus, $16,000,000 worth of assets is owned by Air Reduction Sales Company, $2,000,000 by Pure Carbonic, Inc., and $1,600,000 by National Carbide Corporation. (Resp. Ex. A, B, and C.)[2] They each have their own officers and employees and, through a combination of their assets and the services of their employees, each corporation manufactures its own products which are sold to the public at a profit. Air Reduction Sales Company's net sales exceeded $15,000,000, and it enjoyed a net income which exceeded $3,000,000; Pure Carbonic, Inc., had net sales in excess of $4,000,000, with a net income in excess of $150,000; National Carbide Corporation's net sales were in excess of $3,000,000, and its net income exceeded $800,000. (R. A. 9-10; Resp. Ex. A, B, and C.) The Tax Court ruled that the taxable income of each taxpayer was equal to 6 percent of its capital stock, which was only nominal in amount, this being the portion of the earnings which the taxpayers were entitled to retain under contracts in which they had agreed to pay the balance of their profits to the parent company.

The Circuit Court of Appeals, reversing the Tax Court, correctly held that the taxpayer corpora-

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[2] These exhibits, while not printed in the appendices below, were made a part of the record on review by appropriate order of the court below. (R.A. 36-38.)

tions are taxable on the incomes which they earned, and that they could not escape their tax liabilities even though they were wholly owned subsidiaries of a parent corporation and even though there was an anticipatory arrangement whereby they undertook to pay over the most considerable portion of their earnings to the parent company. In so deciding, the court below properly followed legal principles which have been too firmly established by this Court to admit of any serious dispute.

Possessing inherent control over their corporate assets and profits, and having utilized those assets in combination with the services of their employees to create income, these taxpayers are the economic earners of that income. Because corporations have been selected by Congress as taxable entities they, and not their stockholders, are taxable in the first instance on the business income earned by the corporation. *Moline Properties* v. *Commissioner*, 319 U. S. 436; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415. See *Higgins* v. *Smith*, 308 U. S. 473, 477-478; *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 442; *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, 456. The earnings of the corporation may normally not be regarded as those of its stockholder even where, as here, a single stockholder owns all of the stock and is able to dominate and control the corporation. *Moline Properties* v. *Commissioner*, *supra*; *Burnet* v. *Commonwealth Imp. Co.*, *supra*. Nor may the corporation avoid

being taxed on its income by channeling its earnings directly to its stockholders, for its basic rule that income is taxable to the persons who earns it is as applicable when the taxpayer is a corporation as it is where he is an individual. *United States* v. *Joliet & Chicago R. Co., supra.* The decisions holding various arrangements ineffectual whereby the earner of income attempts to deflect it to another are firmly rooted (*Commissioner* v. *Sunnen*, 333 U. S. 591, and cases cited; *United States* v. *Joliet & Chicago R. Co., supra*) and conclusively demonstrate that, even though the taxpayer corporations here were under agreement to pay all except a minute portion of their earnings to the parent company, this would not suffice to constitute the parent as the taxable owner of the income.

While the taxpayers (Pet. 10-14) assert that the income is taxable solely to the parent because it belonged to it, as principal, and that the taxpayers were acting as corporate agents, there is nothing in the record to substantiate this claim. On the contrary, the uncontradicted facts stand in complete refutation. Even under local law concepts respecting the principal-agent relationship, it seems plain that none was created here. A common law agent must possess power to "bind" a principal, *i.e.*, to alter legal relationships between the principal and third persons. See Restatement of the Law of Agency, Section 12. The subsidiaries here by agreeing to use their own manufacturing plant, and

to utilize their own services, in order to create their own products, which were sold to the public as their own, were not granted any authority to alter legal relationships between the parent corporation and anyone else. Consequently, no principal-agent relationship was created even though the subsidiaries, as self-styled agents, agreed to relinquish the most substantial part of their profits to the parent. However, regardless of how local law would classify such a contract, it is manifest that the economic earner of the income cannot place himself beyond the reach of the taxing statute by agreeing that another shall be the "owner" of the income which is produced by his own property and services, and by denominating the parties as "agent" and "principal." The taxing statute is not concerned with the words or forms by which the parties may choose to label a situation. Cf. *Griffiths* v. *Commissioner*, 308 U. S. 355; *Higgins* v. *Smith*, 308 U. S. 473; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44. Absent a true principal and agent relationship, calling the corporation an agent of the stockholder is only another manner of contending that the corporate entity should be disregarded. *Moline Properties* v. *Commissioner*, 319 U. S. 436, 440-441.

The court below, accordingly, was altogether correct in ruling that the corporate identities of the taxpayers were not to be disregarded, and in holding that they were taxable on their earnings unaffected by the circumstance that, after being

earned, those profits were routed to the parent stockholder by a contractual device rather than through the normal declaration of dividends. The Tax Court's ruling to the contrary was erroneous as a matter of law, and was properly reversed by the Circuit Court of Appeals.

2. There is no conflict in decisions. *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, which the Tax Court thought required the subsidiaries' earnings to be taxed to the parent (R. A. 29-32), and which the taxpayers now rely on as supporting their "agency" argument and as creating a conflict in decisions (Pet. 10-14), has no bearing on this case. Except for the circumstance that both cases have a parent corporation and a wholly owned subsidiary in the picture, they possess nothing in common respecting their factual situations, the issues presented for decision, or the principles to be applied.

In *Southern Pacific Co.* v. *Lowe*, *supra*, the subsidiary owned certain railroad property which it leased to the parent which used it in operating its railway system. The principal source of the subsidiary's income was derived from the rental payments made by the parent company. The subsidiary had a large book surplus on January 1, 1913, largely in the form of a debit against the parent, and in 1914, it paid certain dividends to the parent, the payments being effectuated largely by bookkeeping entries. The issue in the case was whether the parent was taxable on the portion of the divi-

dends derived from the subsidiary's pre-1913 earnings. In holding that the parent was not taxable, the Court ruled that the relationship between the corporations had been such that the income had (p. 337) "in truth and in substance" accrued to the parent before 1913 and that Congress had not intended to tax such income.

The issue in the present case is whether a subsidiary, regardless of the affinity between it and its parent corporation, can escape being taxed on the income which it earns. *Southern Pacific* v. *Lowe, supra*, could not be in conflict with the decision below for no such question was there decided; on the contrary, it had been conceded, in effect, that the subsidiary there was taxable on its income since it had consistently paid the taxes on its earnings.[3] The only question in that case concerned the parent's taxability on dividends paid out of the pre-1913 earnings of the subsidiary; there was not even any issue respecting the parent's tax liability on the dividends paid out of the subsidiary's post-1913 earnings, since it had actually paid the tax on

[3] No. 452, October Term, 1917, R. 183-185, Plaintiff's Exhibit O, being a letter from the Commissioner of Internal Revenue to the subsidiary (Central Pacific Railway Company) recommending additional excise taxes on income for the years 1909-1912; R. 186-189, Plaintiff's Exhibit P, being the income tax returns of the subsidiary for the calendar year ended December 31, 1913, and for the six months ended June 30, 1914; R. 190-191, Plaintiff's Exhibit Q, showing changes made by the Internal Revenue Department in the subsidiary's return of annual income for the fiscal years ended June 30, 1910, to June 30, 1914; R. 192, Plaintiff's Exhibit R, showing income and profit and loss on which the subsidiary paid income taxes for the fiscal years ended June 30, 1910, to June 30, 1914.

such dividends.[4] It is thus clear that *Southern Pacific* v. *Lowe*, in passing on what had become income prior to March 1, 1913, decided nothing which is pertinent to this case or which is in conflict with the decision below. Indeed, the opinion there (pp. 338-339) noted that the case turned on its own peculiar facts, and this observation has been reiterated in other decisions which recognize that the case did not lay down any general rule for deciding tax controversies. *Lynch* v. *Hornby*, 247 U. S. 339, 346; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415, 420; *Moline Properties* v. *Commissioner*, 319 U. S. 436, 439.

The Tax Court was mistaken in interpreting the *Southern Pacific* case as permitting the corporate entities of the taxpayers here to be disregarded and as requiring that their earnings be taxed to the parent company. The taxpayers are equally mistaken in attempting to support the Tax Court on grounds of an "agency relationship" (Pet. 10) for, as indicated, the *Southern Pacific* case decided nothing about the subsidiary's earnings being tax-

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[4] The opinion of the District Court, 238 Fed. 847, 848 (S.D. N.Y.), shows that the parent received dividends of $912,497.48 on January 13, 1914, and states that this "* * * represents only the portion of the dividend paid on January 13, 1914, which the plaintiff claims exceeded the net earnings of the company during the period." The dividends actually received on that date totalled $4,036,530, of which $3,124,032.52 were included in the parent's tax return, the balance of $912,497.48 being excluded because not paid out of post-1913 earnings. The parent also received a dividend on June 30, 1914, on preferred stock of $522,000, which amount was also included in its tax return. See No. 452, October Term, 1917, *supra*, R. 148, Plaintiff's Exhibit 2-H.

able to the parent. Although, in describing the relationship between the corporations in the *Southern Pacific* case, the Court did (p. 337) refer to the subsidiary as an "agent" of the parent, it plainly did not employ that term in a technical sense, and it certainly did not use that description in the same manner as the taxpayers do here, for there it was the parent which utilized the subsidiary's railroad property in conducting the business, while in the present case the subsidiaries are the corporations which not only own the property, but which are also actively engaged in conducting the business. Further, as already demonstrated, no genuine agency relationship between the parent and the subsidiaries exists in this case. *Southern Pacific* v. *Lowe*, accordingly, cannot be in conflict with the decision here, and the Circuit Court of Appeals correctly held that the case is not controlling.

There is nothing even in (Pet. 13) "the implications of the decision" in *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, which conflicts with the decision here. In holding that the parent corporation in that case was not entitled to a deduction for payments made to reimburse its subsidiary corporation on account of its operating deficits, the Court, even if it should be understood as intimating that the deduction would have been allowed to the parent under other circumstances (See Pet. 12), did not imply that the subsidiary's earnings would be directly taxable to the parent. Finally, *Moline Properties* v. *Commissioner*, 319 U. S. 436

(Pet. 12), which decided that corporate gains are taxable to the corporation and not to its sole stockholder, far from being a direct or indirect source of conflict, is the latest expression of this Court which marks the correctness of the decision below. It demonstrates (pp. 440-441) that unless the corporation is truly acting as an agent with respect to the stockholder's property, the type of agency argument which the taxpayers here advance cannot avail to make the stockholder the taxable owner of the corporation's income. While in the *Moline* case the Court noted the absence of (p. 440) an "actual contract of agency", it would be difficult to assume that a different result would obtain merely because the parties speak in agency terms and reduce an agreement to writing, but do not actually created a true agency relationship.

3. Relying on *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231, the taxpayers state (Pet. 14):

> The Circuit Court of Appeals exceeded its powers of review and so far departed from the accepted and usual course of judicial procedure in like cases as to call for the exercise of this Court's powers of supervision and correction.

This assertion is based on the assumption that the issue in the Tax Court was a simple factual question; namely, whether an agency relationship existed between the subsidiaries and the parent, and on the further assumption that the Tax Court did no more than to resolve this fact issue in

favor of the taxpayers. (Pet. 14-15.) We disagree.

No matter with what inflections its opinion be read, when considered in its entirety it can leave no doubt that the Tax Court decided that the relationship between the parties brought the taxpayers (R. A. 32) "* * * within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra*" and that that case required a deviation from the usual doctrine of not disregarding corporate entities (R. A. 29) "where the subsidiary is so much a part of the parent in its operations that it amounts to no more than a mere department or agency." The principles applied by the Tax Court were such that the correctness of its decision depended, not on its appraisal of the undisputed facts, but on its construction of the judicial decisions interpreting the intention of Congress in the taxation of corporations. This was the manner in which the Circuit Court of Appeals, too, considered the Tax Court's decision. (R. C. 8-9.) The issue thus raised was one on which the reviewing court was empowered to reverse if it had been erroneously decided by the Tax Court. *McWilliams* v. *Commissioner*, 331 U. S. 694; *Crane* v. *Commissioner*, 331 U. S. 1; *Commissioner* v. *Wilcox*, 327 U. S. 404; *Trust of Bingham* v. *Commissioner*, 325 U. S. 365.

Even if the Tax Court had actually decided the case as though no generalizing principle were involved, the Circuit Court of Appeals would still have been required to reverse. As we have pre-

viously shown, there is nothing in the record to support the conclusion that there was a principal-agent relationship which would suffice to make the parent the taxable owner of the income. Accordingly, any contrary conclusion drawn by the Tax Court would have lacked support in the record.

We also disagree with the taxpayer's contention that the scope of the reviewing court's authority in this case poses an important question because Section 1141(a) of the Internal Revenue Code was amended by Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess., which, effective September 1, 1948, makes the decisions of the Tax Court subject to review by the Courts of Appeals "* * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury * * *." Since the court below was fully empowered to reverse under Section 1141(c) of the Internal Revenue Code, as interpreted by *Dobson* v. *Commissioner, supra,* it would plainly have no less authority under the new amendment which was intended to abrogate the so-called *Dobson* rule and which was not intended to narrow the functions of the reviewing court. The taxpayers, accordingly, are requesting an academic discussion by this Court on the precise authority of the Courts of Appeals under the amendment to Section 1141(a), when the problem has no bearing on this case.

4. There are no other reasons why the writs should be granted. In the *Moline Properties* case,

supra, certiorari had been granted to resolve the then existing conflict in decisions respecting the integrity of the corporate entity for tax purposes and the taxability of corporate income *vis a vis* stockholder and the corporation. The failure of the Tax Court to follow that decision in a particular case, even though all its members participate (Pet. 16-19), does not require this Court to pass upon the matter again, and to reiterate principles which have already been laid down for the guidance of the lower tribunals. The Circuit Court of Appeals was competent to reverse an erroneous decision where that guidance had been ignored. Further review by this court is not warranted.

CONCLUSION

There is no conflict in decisions. The case was correctly decided by the court below in accordance with the controlling decisions of this Court. The petition for writs of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

GEORGE A. STINSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

AUGUST, 1948.

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

* * * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000 * * *.

* * * * *

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *.

* * * * *

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is author-

ized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

SEC. 602. EXCESS-PROFITS TAX.

(a) If any corporation is taxable under section 601 with respect to any year ending June 30, there is hereby imposed upon its net income for the income-tax taxable year ending after the close of such year, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 per centum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

* * * * *

T. D. 4829, 1938-2 Cum. Bull. 98:

EXCESS-PROFITS TAX

Regulations Relating to the Excess-Profits Tax Imposed by Section 602 of the Revenue Act of 1938

* * * * *

ART. 2. *Scope of tax.*—The excess-profits tax, imposed by section 602 of the Revenue

Act of 1938, is imposed upon the net income of every corporation for each income-tax taxable year ending after the close of any year ending June 30 in respect of which the corporation is subject to the capital stock tax imposed by section 601 of that Act.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 13–1. *Tax on corporations in general.*—Section 13 imposes an income tax on corporations in general the net income of which is more than $25,000.

* * * * *

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116). In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets.

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 151

NATIONAL CARBIDE CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 152

AIR REDUCTION SALES COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 153

PURE CARBONIC, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 6–35) are reported at 8 T. C. 594. The

opinion of the Court of Appeals (R. 274–280) is reported at 167 F. 2d 304.

JURISDICTION

The judgments of the Court of Appeals were entered on March 31, 1948 (R. 281–283). A petition for rehearing (R. 284–288), filed on April 15, 1948, was denied on April 19, 1948 (R. 288). A petition for writs of certiorari was filed on July 14, 1948 (R. 290), and was granted on October 11, 1948 (R. 289). The jurisdiction of this Court is conferred by 28 U. S. C. 1254.

QUESTION PRESENTED

The taxpayers are regularly organized corporations, owning valuable assets and employing officers and employees. They are engaged in businesses in which they utilize those assets and the services of their employees to manufacture products which they sell to the public at a profit. All of their capital stock is owned by a common parent corporation, to which, by written contract, they have agreed to pay over all except a nominal part of their earnings.

The question is whether the Court of Appeals was correct in holding that the taxpayers were taxable on all the income which they earned, and in reversing the Tax Court which had ruled that they were not taxable on the portion of their income which they paid over or credited to the parent corporation pursuant to their agreement.

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and other authorities involved are set forth in the Appendix, *infra*, pp. 61–63.

STATEMENT

These proceedings involve asserted deficiencies in income and declared value excess profits taxes for the calendar year 1938 (R. 6). The following is a summary of the findings of fact of the Tax Court which are deemed to have a material bearing on the controversy.

The taxpayers are: National Carbide Corporation, Air Reduction Sales Company, and Pure Carbonic, Inc., sometimes referred to, respectively, as "Carbide," "Sales," and "Carbonic." Each taxpayer is a separately organized corporation and all of the capital stock of each is owned by Airco Reduction Company, Inc., which will be referred to as "Airco" or the parent company. The taxpayers possessed only a nominal capitalization, *i. e.*, Carbide's outstanding capital stock was 50 shares of $100 par value per share, Sales had 125 shares of $100 par value, and Carbonic had 50 shares of $100 par value. (R. 8, 12.)

Each of the taxpayers is engaged in the manufacture and sale of the following products: Sales—the gaseous constituents of air, hydrogen, acetylene, and tools and apparatus for the utilization of these gases, as well as containers for the transportation of acetylene gas; Carbide—cal-

cium carbide used in the making of acetylene gas, part of the product being used by Sales and the remainder being sold to customers who manufactured acetylene; Carbonic—carbon dioxide in gaseous and liquid form (carbonic acid gas) and also in solid form (dry ice). Another subsidiary of Airco, Wilson Welder & Metals Company, Inc. (referred to as Welder), which is not one of the taxpayers, was engaged in the manufacture, assembly and sale of electric arc welding machines, welding rods, equipment and supplies. (R. 8–9.)

The corporate existence and business of the taxpayers, as they existed during the taxable year, are the products of long and somewhat involved histories only the outlines of which need be sketched. From the time of Airco's establishment in 1915, it organized or acquired control of numerous subsidiary companies. It acquired the stock of these companies either by paying cash or issuing its own stock for the capital stock of those companies. Thereafter, Airco brought about a simplification of the underlying corporate structures. It did this by dissolving, merging and consolidating these numerous subsidiaries so that, during the taxable year, its principal subsidiaries were the three taxpayer corporations and Welder (R. 12–21).

In this process of simplification, title to the principal assets, consisting of plant, machinery, equipment, etc., previously owned by numerous subsidiaries, was transferred to the three tax-

payers at Airco's direction.[1] Airco also acquired the assets and businesses of other corporations and title to those assets was in turn transferred to the taxpayers. Airco, in addition, supplied the taxpayers with a certain amount of initial working capital in the form of cash. (R. 12–13, 14, 16, 20.)

Either as originally incorporated or because of subsequent reductions, the taxpayers possessed only a nominal capitalization. That capitalization was not increased to reflect the value of the assets, title to which was acquired by the taxpayers in the manner described, and which they employed in their respective businesses. Instead, each taxpayer showed a book indebtedness to the parent for the value of those assets as well as for the cash with which they were supplied for working capital. (R. 21–22.) In the course of the operation of their businesses, the taxpayers purchased and acquired title to additional assets. The value of these was also reflected in the form of a book-indebtedness to the parent. The only assets used by the taxpayers which did not belong to them and which, instead, were owned by the parent, consisted of certain gas cylinders. These cylinders were allocated to the various taxpayers by the parent as needed, but no rental or other charge was made for their use.

[1] No further mention is made of Welder since it is not involved in this case.

The parent company and each of the taxpayers (or a predecessor in interest) had entered into separate agreements which were in effect during the taxable year. The agreement between the parent and Sales, which is typical, provided as follows (R. 13–14):

> That for good and valuable considerations each to the other given and received, the parties hereto hereby agree as follows:
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> First.—Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases, which it or its subsidiary or controlled companies now own or control, or which it or they may hereafter build or acquire; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants.
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> Second.—This contract, and the said employment of Sales hereunder, shall continue until December 31st, 1917; and thereafter shall continue from year to year subject to the right of either party to terminate the same at any time by giving thirty days previous written notice to the other of its intention so to do.
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> Third.—Airco agrees (1) to give Sales the use of all cylinders, containers, motor trucks, equipment, and shipping facilities, which it now owns or may hereafter ac-

quire; (2) to supply such working capital as Sales may need; (3) to provide such executive management (but not accounting, bookkeeping and clerical service), and office accommodation and facilities, as may be necessary for the proper conduct of Sales business; and (4) to procure for Sales such contracts with Airco's subsidiary or controlled companies as will enable Sales to exercise in each case the agency hereby created, and as will in each case constitute Sales the agent of such subsidiary or controlled company.

Fourth.—Sales agrees (1) to manage and operate efficiently and carefully all of said plants; (2) to maintain the same in first class condition, charging necessary repairs and replacements to operating expense and setting aside and charging to operating expense proper reserves for depreciation and for wear and tear not immediately replaceable by repairs; (3) to distribute, market and sell, the product manufactured in said plants as efficiently as possible, realizing, to the best of its ability, the largest obtainable gross receipts therefrom; (4) to pay all expenses of such operation, maintenance and selling, and to discharge all expenses or liabilities incurred therein or thereby and to collect all accounts receivable or other proceeds resulting therefrom; (5) to credit monthly on its books to Airco all profits accruing to it from the operation of its entire business over and above an amount equal to

six per cent. (6%) per annum on its outstanding capital stock, which said amount it is hereby authorized to deduct and retain, and it hereby agrees to accept as full compensation for its services hereunder; and (6) to pay over to Airco upon demand any profits becoming due and credited to Airco as aforesaid.

Pursuant to the agreements, the taxpayers (in addition to the indebtedness reflecting the value of all their assets) credited to the accounts payable to the parent the net proceeds from their business operations, minus the nominal amounts which they purported to accept as payment for their services under the agreements. No interest ran on any of the accounts payable to the parent. (R. 21–22.)

As the sole stockholder, and by means of common directors and officers, the parent company dominated and controlled the subsidiaries in the conduct of their respective businesses. In certain respects, this control extended to the minutest detail. The parent was thereby also able to achieve a certain integration and correlation of the business activities of the taxpayers. All transfers of materials and supplies between one taxpayer and another were clearly reflected on their books. (R. 22–28.)

Asserted deficiencies in income and declared value excess profits taxes for the taxable year 1938 resulted from the Commissioner's determi-

nations that the income of each taxpayer should include the entire earnings from its business activities and not merely the amounts which had been credited to its own accounts as being due under the so-called "agency" contracts (R. 6–11, 38–42). The Tax Court, Judges Van Fossan, Arnold and Opper dissenting, refused to sustain the Commissioner's deficiency determination (R. 29–35). The Court of Appeals reversed the Tax Court and reinstated the Commissioner's deficiency determinations (R. 274–280).

SUMMARY OF ARGUMENT

I

The taxes which are involved in these cases have been imposed by Congress on corporations as separate tax entities. The taxing statute thus recognizes that the corporation and its stockholders are distinct taxpayers and that the corporation must be taxed on the income which it earns in the conduct of the corporate business. Even though all its stock is owned by a single individual or by another single corporation, the income earned by the corporation remains taxable to it. *Moline Properties* v. *Commissioner*, 319 U. S. 436; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415. The corporation remains taxable on income attributable to the corporate property even though the payments are made by the transferee directly to the stockholders and even though

the corporation has divested itself of all control over the property. *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44. Nor may these tax results be avoided by an arrangement in which the corporation and its stockholders agree that the corporation's income shall be considered as belonging to the stockholders. Such an agreement is no more effectual in shifting tax liabilities than is any other kind of anticipatory arrangement whereby income is assigned from the person who earns it to another who does not.

The taxpayers here are corporations engaged in the business of manufacturing products and selling them to the public. In carrying on this business, they utilize assets of considerable magnitude which they own in their corporate capacities and they utilize the services of their own officers and employees whom they employ in their corporate capacities. As a result, the taxpayer corporations are taxable on the profits which they create in the conduct of their corporate businesses, in the same fashion as is any other corporation. This tax liability cannot be shifted at their instance to their sole stockholder, a parent corporation, because of any supposed rule of law permitting their corporate entities to be disregarded, as the Tax Court held, or because, as the taxpayers now argue, they and their parent have agreed that the parent should be the owner of the taxpayers' profits as a "principal."

There are no facts in this case which would permit the conclusion that the taxpayers were acting as agents for their stockholder, the parent company. Nor did the Tax Court decide otherwise. Though labelled a contract of agency, the agreement that the parent company should be the owner of the income is, in the circumstances of this case, no different from a simple anticipatory assignment of future income which will not relieve the assignor from tax. Nor may the taxpayers achieve the same result by claiming that, in agreeing to pay over their profits to their stockholder, they have incurred deductible business expenses. The stockholder will normally receive his interest in the corporate profits through the channel of dividends. A deductible ordinary and necessary business expense does not arise out of a corporation's advance agreement to pay over its profits to its stockholder.

II

The authority of the Court of Appeals was not so limited as to make a reversal of the Tax Court's decision improper in this case. Whether the Tax Court's decision be regarded as one in which it applied a wrong principle of law, or one in which it drew a conclusion which lacked any rational support in the record, or a combination of both, its decision was wrong and the Court of Appeals was required to correct it.

ARGUMENT

I

THE TAXPAYER CORPORATIONS ARE TAXABLE ON THE PROFITS WHICH THEY EARNED IN CARRYING ON THEIR RESPECTIVE BUSINESSES

A. BY IMPOSING A TAX ON CORPORATIONS, CONGRESS HAS REQUIRED THAT INCOME EARNED BY THE CORPORATION BE TAXED TO IT

The ultimate question in these cases is whether a corporation, as the Court of Appeals held, is to be taxed on its income where (1) the corporation is regularly organized, (2) it utilizes assets which it owns and the services of its own officers and employees to manufacture products which it sells to the public at a profit, but (3) it has agreed to pay over the most considerable part of its earnings to its sole stockholder by direct payments rather than in the form of dividends.

We believe that the consistent course of decisions of this Court permits the question to be answered in only one way, namely, that such income must be taxed to the corporation, and that the taxable incidence may not be shifted at its instance to its parent. The answer must be the same, moreover, whether the problem is expressed in terms of disregarding corporate entities, as the Tax Court did in its opinion, or in terms of principal and agent, as the taxpayers now attempt to explain the matter. The Court of Appeals, in deciding that the income in ques-

tion must be taxed to the taxpayer corporations, reached the only permissible result.

By imposing an income tax on corporations, Congress has selected a juristic entity for taxation.[2] The statute makes the corporation and its stockholders separate and distinct taxpayers. Each is taxable on its own income; the corporation on the income which is earned by it in conducting the corporate business, the stockholder on the income which he earns. The stockholder's income, of course, will include such income (dividends, for example) which may derivatively flow to him from the corporation because of his stock ownership. *Moline Properties* v. *Commissioner*, 319 U. S. 436; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415; *Higgins* v. *Smith*, 308 U. S. 473, 477–478; *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 442; *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, 456.

A necessary concomitant of this principle is the conclusion that the taxable income of the corporation retains its separate identity even

[2] Section 13 (b) of the Revenue Act of 1938 (Appendix, *infra*, p. 61), with certain exceptions not material here, imposes a tax on the income of every corporation having net income in excess of $25,000. Section 602 (Appendix, *infra*, p. 62) imposes a tax on every corporation liable for the capital stock tax under Section 601, the tax being on net income in excess of 10 percent of the adjusted declared value of its capital stock. Liability for income and declared value excess profits taxes is involved in these cases.

though all its stock is owned by one individual or by another single corporation. This is so because Congress, having drawn the line so as to make a clear division between the corporation and its stockholders, has plainly decreed that this dichotomy must exist for tax purposes even though the corporation is only a fictitious being created by local law, and even though, in many respects, the separation between the sole stockholder and the corporation may be an economic formalism. The corporation, therefore, not its sole stockholder, is by statute declared to be the economic earner of the profits created through its corporate business activities. *Moline Properties* v. *Commissioner, supra; Burnet* v. *Commonwealth Imp. Co., supra;* cf. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590.

The present cases also necessitate the application of another, but equally fundamental, principle which requires that income be taxed to the taxpayer who earns it, and which ignores as ineffectual any arrangement by which such income is deflected to or channeled through another. Thus, a corporation is taxable on income attributable to the corporate property even though it has caused the income to be paid directly to its stockholders and has relinquished the right to receive the income itself. *United States* v. *Joliet & Chicago R. Co., supra.* Cf. *Raybestos-Manhattan Co.* v. *United States,* 296 U. S. 60. The *Joliet* case, involving a corporate taxpayer, is but a

specific example of how this Court, in various situations, has held a wide variety of such anticipatory assignments to be ineffective for the purpose of shifting tax liabilities. *Commissioner* v. *Sunnen*, 333 U. S. 591; *Commissioner* v. *Tower*, 327 U. S. 280; *Lusthaus* v. *Commissioner*, 327 U. S. 293; *Harrison* v. *Schaffner*, 312 U. S. 579; *Helvering* v. *Horst*, 311 U. S. 112; *Helvering* v. *Eubank*, 311 U. S. 122; *Helvering* v. *Clifford*, 309 U. S. 331; *Douglas* v. *Willcuts*, 296 U. S. 1; *Burnet* v. *Leininger*, 285 U. S. 136; *Lucas* v. *Earl*, 281 U. S. 111.

B. THE UNDISPUTED FACTS SHOW THAT THE INCOME WAS EARNED BY THE TAXPAYER CORPORATIONS AND NOT BY THEIR PARENT COMPANY

The Tax Court, while recognizing the general applicability of the principles just summarized, took the view that there is another principle of law, announced by this Court in *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, which, in certain exceptional circumstances, demands that a corporate entity be ignored for tax purposes. We shall show, in Point I C, *infra*, pp. 30–40, that the decision in the *Southern Pacific* case has no application to the facts of this case, no matter how they be viewed. Before doing so, however, we will, in this section of the brief, analyze those facts which the Tax Court deemed significant in order to demonstrate that, contrary to the legal conclusion reached by the Tax Court, every reason exists in these cases for giving positive affirma-

tion to the general principles, already outlined, which require that the income be taxed to the taxpayer corporations.

The Tax Court said (R. 30–32):

> We summarize as follows some of the facts which have brought us to this conclusion: The capital stock of each petitioner [taxpayer] is nominal in amount and is all owned by Airco. The members of the board of directors of each petitioner are elected by Airco and, with one exception, they are all senior executive officers of Airco. The chairman of the board of directors of Airco was also chairman of the board of directors of each petitioner. The president of Airco was also a director of Airco and of each petitioner. The Airco board held regular meetings and exercised complete domination and control over the business of Airco and each of the petitioners. The board of directors of the petitioners held an organization meeting each year and thereafter only met when called upon by Airco to formalize action taken by the Airco board. The chairman, vice-chairman and president of Airco were in charge of the administration and management of the activities of each petitioner and carried out the policies and directives with respect to each petitioner as promulgated by the Airco board. One main office was maintained for Airco and the petitioners in the Lincoln Building, New York, N. Y., and, with two minor exceptions, the offices of

all the executive officers of Airco and the petitioners were located there. * * * The business of the parent and the petitioners was conducted as one business unit divided into six branches: corporate operations, sales, financial, distribution and research. Each of the six main branches was directed by a senior officer of Airco. The subdivisions of each of the six branches were also directed and managed by officers of Airco. All employees in each of the six branches performed their duties for Airco and each petitioner whenever and wherever their services could be utilized in connection with the operations of any of the petitioners. All expenditures for Airco and each petitioner of more than $500 required specific approval of the Airco board of directors and its chairman. * * * All purchases for each petitioner from persons outside the affiliated group, except emergency purchases up to $50, were made only upon orders issued by the general purchasing agent of Airco. Products produced by or materials purchased for one agency company were often transferred to another agency company. Where this was done the transfer was reflected on the intercompany accounts at cost without the passage of any cash. There were no intercompany profits. All bank accounts maintained in the name of each petitioner were treated by Airco as its own and were drawn upon indiscriminately by it when money was

> needed by any company. There was substantial identity of officers authorized to sign checks on the bank accounts of Airco and on the bank accounts of each petitioner. All credits and collections were in charge of the Airco credit manager. Airco maintained pension systems for all employees of all companies. Accounting was done for all companies by one general accounting office under the general auditor of Airco and accounting procedure was uniform. * * *

These facts could be more tersely summarized by concluding that the parent corporation, as the sole stockholder, exercised complete and ultimate control over each of these subsidiaries, and that each of the subsidiaries here conducted its business in accordance with the dictates of its sole stockholder. While the pattern here is more complex, the situation is not essentially different from that which exists where an individual is the sole stockholder of a corporation. In both instances, the stockholder's control over the affairs of the corporation is equally stringent. In both situations, the corporation carries out the mandates of its stockholders with the same degree of subservience. Indeed, it would require the greatest naivete to assume that such a corporation does not, in the final analysis, conduct its business to conform to the purposes of its single stockholder, whether that stockholder be an individual, as in

the *Moline Properties case* (319 U. S. 436), or an estate, as in the *Commonwealth Imp. Co.* case (287 U. S. 415), or another corporation, as here.[3]

The Tax Court, however, failed to appreciate that the existence of the corporation as a taxable entity does not turn on the number of its stockholders or on the degree of supervision and control to which it is subjected. The actions of the board of directors, however much they may be dictated by even the sole stockholder, constitute the action of the corporation and not of the stockholder. This cannot be gainsaid by characterizing the director's decisions, as did the Tax Court here, as serving only to "formalize" the desires of the stockholder. Likewise, the actions of any officer or employee of a corporation are no less the actions of the corporation because that person may be the stockholder or hold a position with a stockholding parent. These are not only truisms of general corporate law; they are equally vital in the taxation of corporations. They show that the corporation is the earner of, and is taxable on, the profits which it creates, and that the corporation's income is not the stockholder's in-

[3] Petitioner seeks to distinguish the *Moline* case as being one in which the corporation was "'clearly not'" the sole stockholder's "'*alter ego*'" and "'that his exercise of control over it was negligible.'" (Br. 18.) But as the opinion of this Court makes clear (319 U. S. at 440), the Court, at that point, was speaking of a period earlier than the tax years involved in the case. Later, "in 1933" as this Court stated, "control of petitioner reverted" to the sole stockholder. 319 U. S. at 437

come even though there is but a single stockholder, and even though this stock ownership enables the sole stockholder to control the corporation in every respect. *Moline Properties* v. *Commissioner*, 319 U. S. 436; *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415.

The Tax Court also pointed out (R. 31) that:

> Advertising was conducted under one advertising manager and through this medium Airco represented to its stockholders and the general public that the petitioners [taxpayers] were divisions of the parent company.

Again, it is difficult to perceive how this fact could have any possible bearing on the tax result. Whatever representations were made by the parent to its stockholders, or to the public, cannot nullify the corporate existence of the subsidiaries or obscure the substantial business activities in which they were engaged. Moreover, it will be noted that the Tax Court does not deny that the subsidiaries were represented to the stockholders and to the public as being separate corporations. The evidence, it is believed, would admit of no dispute on that point.[4]

[4] See Respondents' Exhibits 25–30. (The original exhibits in this case are not printed as part of the record in this Court but are on file in the office of the Clerk.) These exhibits actually show that the taxpayers were represented to the public as separate corporations. There is no evidence to the contrary.

The Tax Court also believed it to be significant that (R. 31):

> All assets held by each petitioner [taxpayer] were furnished to it by Airco which paid for them with its own cash or stock. Airco supplied all the working capital of each petitioner.

The more detailed findings of fact concerning the method by which the taxpayer corporations were financed appear at R. 12–20, 21–22. They show that, while each of the subsidiary corporations was given only a nominal capitalization, the parent company had consolidated in each of the taxpayers the assets of numerous other corporations. While there is no explicit finding on this, it is undisputed that title to these assets was transferred to the taxpayers and that they acquired title to additional assets by purchases made in the course of their business operations. Each subsidiary, on its books, showed an indebtedness to the parent reflecting the value of all those assets. The parent had supplied each subsidiary with initial working capital, and each was permitted to augment this, to the extent necessary, out of earnings. The subsidiaries also showed a book indebtedness to the parent for the amount of all working capital. It was in this manner that the parent "furnished" and "supplied" the assets and working capital which, it should be emphasized, were owned by the subsidiaries.

What significance, then, is there in the circumstance that part of the capital utilized by the taxpayer-corporations here originated with the stockholder, and that part was derived from the reinvestment by the taxpayers of their own earnings in their businesses? The assets of any corporation are a combination of the capital contributions made by the stockholders, the funds which the corporation is able to borrow, and the earnings which the corporation is able to reinvest in the business. Where there is a single stockholder, of course, the entire capital contribution must originate with that stockholder. The important thing is that every corporation (even where it has only one stockholder) is the owner of the assets derived from those funds. Where the corporation is engaged in a business in which those assets are employed, it is the owner of the earnings thereby created, and the entity to which those earnings are taxable.

In the present case, the amount of the assets of the subsidiaries which the parent furnished in the form of capital stock contributions is nominal. The amount of the assets which it purported otherwise to contribute, and for which the subsidiaries showed a book indebtedness to the parent, is most substantial. It is not necessary, in the present controversy, to determine whether the latter are truly loans or constitute additional capital contributions. If it were pertinent here, it might be observed that the absence of a definite

time being specified for repayment, the fact that no interest was payable on the purported indebtedness, and the inability of the subsidiaries ever to make repayment except upon dissolution,[5] would, altogether, be strongly persuasive that the parent did not intend to make loans which would be repaid, and that this was only a capital contribution which enhanced the stockholder's equity in the subsidiary corporations. *American Cigar Co.* v. *Commissioner,* 66 F. 2d 425 (C. C. A. 2d), certiorari denied, 290 U. S. 699. Cf. *Pepper* v. *Litton,* 308 U. S. 295.[6] At all events, whether the assets owned by the subsidiaries were acquired by way of capital contributions or by way of borrowed capital, the ultimate fact remains that these assets were owned by the subsidiaries and were employed in their respective businesses. The circumstances that the capital, in one form or another, all emanated from a single stockholder

[5] The value of the total assets owned by each taxpayer was almost equivalent to its book indebtedness to the parent. Respondents' Exhibits A, B, and C. Since the taxpayers, in addition, were purportedly under an obligation to pay over to the parent each year substantially all their earnings, there was no way in which they could pay off the indebtedness for their assets, short of dissolution.

[6] The Court in *Pepper* v. *Litton*, *supra*, said (pp. 309–310):

> And so-called loans or advances by the dominant or controlling stockholder will be subordinated to claims of other creditors and thus treated in effect as capital contributions by the stockholder * * * where the paid-in capital is purely nominal, the capital necessary for the scope and magnitude of the operations of the company being furnished by the stockholder as a loan.

does not serve to insulate the corporation against being taxed on the income which it earned or to impute that income to its single stockholder. *Moline Properties* v. *Commissioner,* 319 U. S. 436; *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415.

Although, in its summary of the significant facts on which it based its decisions (R. 30–32), the Tax Court made no mention of this, its detailed findings of fact show that the parent company retained the title to all gas cylinders (other than acetylene cylinders) and that these were allocated to the various subsidiary companies as required by them (R. 21). Each cylinder had a value of about $15 or $16 (R. 18) and the parent company, in 1938, owned approximately 850,000 cylinders of which 600,000 were in service for Sales and 250,000 for Carbonic (R. 27). The subsidiaries, apparently, were not charged on the books for the use of these cylinders.

These were the only assets used by the subsidiaries which they did not own. It need not be decided whether the use of the cylinders, too, should be viewed as a contribution to capital, for the taxpayers, below, made no claim that the free use of the cylinders resulted in a distortion of their income, and introduced no evidence as to what would have been a reasonable charge for their use. Cf. *Tennessee-Arkansas G. Co.* v. *Commissioner,* 112 F. 2d 508, 510 (C. C. A. 6th). See pp. 52–57, *infra.*

The final circumstances relied on by the Tax Court were (R. 32):

> The proceeds realized from each petitioner's [taxpayer's] activities did not come to Airco as the result of any independent action by the agency company, such as declaration of dividends. A written operating agreement was entered into between Airco and each petitioner under which the petitioner agreed to conduct a branch of the Airco business for a purely nominal fee. In each agreement the agency company agreed to credit, and did credit, monthly on its books to Airco all profits from its operations above the nominal amount of its compensation. The accounts between Airco and each petitioner were kept strictly in accordance with each operating agreement.

The Tax Court, we submit, however, was altogether wrong in concluding that these agency contracts, whatever their legal effect as between the parties themselves, could avail to transform the earnings of the subsidiaries into earnings of the parent. The agreements cannot alter the indisputable circumstance that the subsidiaries, which own the assets and perform the services, are the earners of the profits thereby created and that the parent is not.

That these earnings did not come to the parent through the normal means of dividends being declared by the subsidiaries does not have the

least significance, although the Tax Court believed the contrary to be true. The situation here, in that respect, is governed by *United States v. Joliet & Chicago R. Co.*, 315 U. S. 44. There the corporation leased all its property in perpetuity, the lessee undertaking to make annual payments directly to the corporation's stockholders. The corporation thereafter carried on no active business. It was held, nevertheless, that those payments constituted income taxable in the first instance to the corporation. The Court pointed out that the relationship between the corporation and its stockholders was an abiding one, and that the right of the stockholders to receive the payment was derivative only. That is, the stockholders received the payments because they were stockholders since (p. 48)—

> * * * the rental or purchase payments for the property conveyed by respondent [the corporation] could not lawfully be paid to another without its authority; and it could not lawfully dispose of them to others without the consent of its shareholders.

Accordingly, it was held that the corporation, by causing the payments to be made directly to its stockholders, was no more relieved of tax than would be true in any other situation where the owner of property attempted to assign the income from that property to another, the opinion citing *Lucas v. Earl*, 281 U. S. 111, and *Helvering*

v. *Clifford*, 309 U. S. 331. As a result, the corporation and its stockholders in the *Joliet* case were in the same taxable situation as would have been true if the payments from the transferee of the property had been first received by the corporation and then paid out by it in the form of dividends to its stockholders. Accord: *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60. The same must be true here where the payments are made to the stockholder pursuant to a contract which seeks to avoid the normal channel of dividend declarations.

Actually, the present cases are *a fortiori* situations for the taxation of the income to the corporation since here the taxpayer corporations carried on business activities of major proportions in the course of which they received the income from the purchasing public, while, in the *Joliet* case, the taxpayer corporation did nothing of an active nature, not even to the extent of collecting the income.

In the final analysis, therefore, the agency agreements here can have no different effect than any other anticipatory assignment of income. Each subsidiary, by a combination of the assets which it owned and the services which it performed, was the earner of the income in question. It is fundamental that the income must be taxed to such earner and that this cannot be avoided by any anticipatory arrangements regardless of the form that they assume. *Commissioner* v. *Sunnen*, 333 U. S. 591, and the other cases cited *supra*,

p. 15. It is also fundamental that a corporation may not attribute the corporate income to its stockholders. Therefore, the subsidiaries here, by agreeing to pay over their earnings to their stockholder and by crediting those amounts on their books, can no more relieve themselves from being taxed on their earnings than the taxpayers in the cases cited above, including *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44.

Since the relationship between a parent corporation and its subsidiaries presupposes a more intimate control than that which could be expected in even the closest knit family, decisions refusing to recognize a reallocation of income within the family group possess a special significance here. Indeed, in considering the effect of these agreements it should not be overlooked that they do not result from any arm's length bargaining, for, as is also apparent from their very terms, the parent corporation dictated their provisions. Agreements of such a nature can scarcely be expected to establish the realities of the situation. Cf. *Bourjois, Inc.* v. *McGowan*, 85 F. 2d 510 (C. C. A. 2d); *Campana Corp.* v. *Harrison*, 114 F. 2d 400 (C. C. A. 7th); *Campana Corp.* v. *Harrison*, 135 F. 2d 334 (C. C. A. 7th). For example, the taxpayer, Air Reduction Sales Company, owned assets in excess of $16,000,000 during the taxable year, its net sales of goods during that period were more than $15,000,000, its cost of producing these goods ex-

ceeded $4,800,000 and its net income after all deductions was $3,314,891.10. (R. 10; Respondents' Exhibit C.)[7] *Despite all this, the taxpayer, Sales, would have the Court conclude that its earnings were only $750.*

A taxpayer that owns assets of such magnitude, that utilizes them, together with the services of numerous employees, to manufacture products which can be sold at so large a profit, cannot, as a matter of reality, be said to do so for a purely nominal consideration—a consideration, it should be noted, which has no possible relationship to the value of its property and services, and which results from a transaction in which it is not a free agent. Its own books show that Air Reduction Sales Company had net income in excess of $3,000,000. The parties cannot, by their own *ipse dixit,* rewrite their tax bills so that these earnings shrink to $750. To permit such a result is to offend the principle that tax consequences flow from the substance of a situation, not from the forms by which it is described. *Gregory* v. *Helvering,* 293 U. S. 465; *Minnesota Tea Co.* v. *Helvering,* 302 U. S. 609; *Griffiths* v. *Commis-*

[7] National Carbide Corporation owned assets of more than $1,600,000, its net sales were in excess of $3,000,000 and its net income was $881,544.30. It was entitled to only $300 under its "agency" contract. (R. 9–10; Respondents' Exhibit A.) Pure Carbonic, Inc., owned assets of more than $2,000,000, its net sales exceeded $4,000,000 and its net income was $157,895.25. It was entitled to only $300 under its "agency" contract. (R. 11; Respondents' Exhibit B.)

sioner, 308 U. S. 355; *Higgins* v. *Smith,* 308 U. S. 473; *United States* v. *Joliet & Chicago R. Co.,* 315 U. S. 44; *Lucas* v. *Earl,* 281 U. S. 111; *United States* v. *Phellis,* 257 U. S. 156.

C. NO PRINCIPLE PERMITS THE CORPORATIONS' INCOME TO BE REGARDED, AT ITS INSTANCE, AS HAVING BEEN EARNED BY THE SOLE STOCKHOLDER

We believe that the foregoing demonstrates that the Court of Appeals was undeniably correct in sustaining the Commissioner's deficiency determination. That conclusion may be confirmed by an analysis of the objections to it raised by the Tax Court and by the taxpayers.

The Tax Court thought that while, normally, the corporate identity is to be respected, and that its income remains separate from that of its stockholders, there are exceptions to this and that the present case constitutes such an exception.

Southern Pacific Co. v. *Lowe,* 247 U. S. 330, was principally, if not exclusively, relied on by the Tax Court as the authority establishing such an exception in the case of a subsidiary corporation which is operated by its parent stockholder as "a mere department or agency," and it concluded (R. 32) that when the facts of the present cases "are viewed together they bring petitioners [taxpayers] within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra.*" An analysis of that case, however, will demonstrate that no such rule of law was announced. Neither that case nor any other deci-

sion of this Court supports the Tax Court in its unwarranted disturbance of the basic structure of the taxing statute in which Congress taxed the corporation, not its sole stockholder, on the corporation's earnings.

Southern Pacific Co. v. *Lowe* involved, as a taxpayer, a parent corporation which owned all the capital stock of a subsidiary. The subsidiary owned certain property, which formed a part of the railway system operated by the parent, and had leased all its property to the parent. Under the terms of the lease, the subsidiary was to receive $10,000 per year for organization expenses and, in addition, all net profits from the operation of the property, except that the parent was to retain one-half of the profits in excess of six percent on the capital stock of the subsidiary. Advances by the parent on behalf of the subsidiary were to bear lawful interest and the parent could reimburse itself at any time for such advances out of earnings in its possession. Necessary funds for additions and betterments or for making up deficits in earnings were advanced by the parent. The subsidiary had no bank account of its own, its earnings being deposited in the parent's bank account.

As a result of the payments due it under the lease and on account of the conversion of certain of its assets, the subsidiary had a large book surplus accumulated as of January 1, 1913, largely in the form of a debit against the parent.

During the first six months of 1914, dividends were declared by the subsidiary, part of which was out of the pre-1913 surplus. No cash was transferred, however, the dividend payments being effectuated by bookkeeping entries which reduced the subsidiary's surplus and also reduced the apparent indebtedness of the parent to the subsidiary.

The issue in the case was whether, *to the extent that the dividends were out of pre-1913 earnings*, the parent realized income which would be taxable to it under Section II G (a) of the Income Tax Act of 1913, c. 16, 38 Stat. 114. Noting that Congress had not attempted to tax income accruing to a taxpayer prior to March 1, 1913 (the effective date of the first income tax law enacted under the Sixteenth Amendment), the Court held that it was the intent of Congress (p. 337)—

> to refrain from taxing that which, in mere form only, bore the appearance of income accruing after that date, while in truth and in substance it accrued before; * * *

After referring to the fact that the parent was in complete control of the subsidiary because of the stock ownership, that the funds were in its actual possession at all times, both before and after the dividend, and that it was a matter of real indifference to the parent when it caused the subsidiary to declare the dividend, the Court

concluded that the income in question had accrued to the parent prior to March 1, 1913, and was not taxable, saying (pp. 338–339):

> Under the circumstances, the entire matter of the declaration and payment of the dividends was a paper transaction to bring the books into accord with the acknowledged rights of the Southern Pacific; and so far as the dividends represented the surplus of the Central Pacific that accumulated prior to January 1, 1913, they were not taxable as income of the Southern Pacific within the true intent and meaning of the Act of 1913.
>
> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised.

A similar result under somewhat analogous facts was also reached in *Gulf Oil Corp.* v. *Lewellyn*, 248 U. S. 71.

The *Southern Pacific* case, in dealing with the parent's liability for tax on payments received by it from the subsidiary, decided nothing about the subsidiary being taxed on the income in the first instance, and thus had nothing to do with the issue presented here, namely, whether the subsidiary corporation is the owner of the earnings to which such income is taxable. Indeed, the record in that case shows that the subsidiary did file tax returns and did pay the tax on the

income which it received.* There was no claim that the subsidiary did not do so properly or that its relations with the parent company were such as to immunize it from liability for tax on its income.

The decision in the *Southern Pacific* case actually turns on the Court's conclusion that the substance of the situation was such that the income had accrued to the parent prior to 1913, and that Congress did not intend to tax income of that character even though, from a purely formal viewpoint, there was a technical realization after that time. This is clear from the actual facts in the case, for the parent company only contended that it was not taxable on such of the dividends as came from pre-1913 earnings. *It did not question its liability for dividends from post-1913 earnings,* and the record shows that it included in its income and paid the tax on such dividends (amounting to more than $3,500,000)

* No. 452, October Term, 1917, R. 183–185, Plaintiff's Exhibit O, being a letter from the Commissioner of Internal Revenue to the subsidiary (Central Pacific Railway Company) recommending additional excise taxes on income for the years 1909–1912; R. 186–189, Plaintiff's Exhibit P, being the income tax returns of the subsidiary for the calendar year ended December 31, 1913, and for the six months ended June 30, 1914; R. 190–191, Plaintiff's Exhibit Q, showing changes made by the Internal Revenue Department in the subsidiary's return of annual income for the fiscal years ended June 30, 1910, to June 30, 1914; R. 192, Plaintiff's Exhibit R, showing income and profit and loss on which the subsidiary paid income tax for the fiscal years ended June 30, 1910, to June 30, 1914.

which were received from the subsidiary during the first six months of 1914.[9] Indeed, the amount of the dividends from the subsidiary on which the parent conceded it was taxable greatly exceeded the amount of the dividends which it was claimed did not constitute income to the parent. And this Court explicitly stated that its ruling applied only (247 U. S. at 338) "so far as the dividends represented the surplus of the Central Pacific [subsidiary] that accumulated prior to January 1, 1913 * * *."

That the case dealt only with pre-1913 earnings and their accrual to the parent prior to that time is not only clear from the issue as presented and decided, but it is also plain from the contemporaneous ruling in *Lynch* v. *Hornby*, 247 U. S. 339, in which it was held that Congress intended to tax an ordinary stockholder on a dividend received after March 1, 1913, even though paid out of earnings accumulated by the corpora-

[9] The opinion of the District Court, 238 Fed. 847, 848 (S. D. N. Y.), shows that the parent received dividends of $912,497.48 on January 13, 1914, and states that this "* * * represents only a portion of the dividend paid on January 13, 1914, which the plaintiff claims exceeded the net earnings of the company during the period." The dividends actually received on that date totaled $4,036,530, of which $3,124,032.52 were included in the parent's tax return, the balance of $912,497.48 being excluded because not paid out of post-1913 earnings. The parent also received a dividend on June 30, 1914, on preferred stock of $522,000, which amount was also included in its tax return. See No. 452, October Term, 1917, *supra*, R. 148, Plaintiff's Exhibit 2-H.

tion prior to that time. The Court pointed out that it was the congressional intent to tax a stockholder on his interest in the corporate profits at the time when it came into fruition through the receipt of dividends, and declared that there were no constitutional obstacles to this even though the dividends came out of pre-1913 earnings. *Lynch* v. *Hornby, supra,* in regarding *Southern Pacific Co.* v. *Lowe, supra,* as resting upon (p. 346) "special facts," and being "plainly distinguishable," showed that the Court was of the undoubted view that the parent's interest in the subsidiary's earnings there had come to fruition and had accrued prior to the occurrence of the paper dividend transaction and prior to the operative date of the taxing statute. This follows inescapably from the Court's extraordinary statement in the *Southern Pacific* opinion itself (p. 338) that "the case turns upon its very peculiar facts."

It is thus not surprising that subsequent decisions of this Court have recognized that the *Southern Pacific* and *Gulf Oil Corp.* cases have little or no precedential value. Thus in *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415, 420, the Court said that those cases—

> cannot be regarded as laying down any general rule authorizing disregard of corporate entity in respect of taxation. These cases presented peculiar situations and

> were determined upon consideration of them. * * *

See also *Moline Properties* v. *Commissioner*, 319 U. S. at 439, in which this Court said that the *Southern Pacific* and *Gulf Oil* cases have been "held to lay down no rule for tax purposes." The court below, in its decision here and also in *Nixon* v. *Lucas*, 42 F. 2d 833, 835, has similarly held that those cases are not applicable in other situations.

Southern Pacific Co. v. *Lowe*, 247 U. S. 330, in construing the 1913 Act and in ruling on what had become income prior to 1913, decided nothing germane to the issue here for it did not purport to decide that in any situation involving post-1913 earnings, the income of a corporation would ever be taxable to anyone other than the corporation itself. Indeed, every subsequent decision of this Court has demonstrated that the corporation cannot shift its tax liability to even its sole stockholder. The Tax Court, accordingly, was altogether mistaken in thinking that the situation here was completely governed by the decision in *Southern Pacific Co.* v. *Lowe, supra.*[10]

[10] The Tax Court relied on two other cases, both decisions of Courts of Appeals, for the proposition that the situation here authorized the disregard of corporate entities. Neither decision constitutes such authority. *Munson S. S. Line* v. *Commissioner*, 77 F. 2d 849 (C. C. A. 2d), which did not involve any question concerning the proper corporation to which income is taxable but, instead, had to do with a special credit granted by Section 23 of the Merchant Marine Act of

The taxpayers seek to present the matter as though *Southern Pacific Co.* v. *Lowe* merely decided that income collected by an agent is taxable to the principal rather than to the agent (Br. 11, 15–21) and that the Tax Court in the present case merely decided that the subsidiary corporations were agents of the parent, so that the income in controversy was taxable to the principal (Br. 11–12, 14–15, 17, 18–19, 25, 28). We believe that both of the above assumptions are without foundation.

Southern Pacific Co. v. *Lowe* did not decide that a principal's income is taxable to the principal rather than the agent and that such a relationship existed between the parent and the subsidiary company there. This should be amply clear from the foregoing analysis of the case,

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1920, c. 250, 41 Stat. 997, is best explained by the court below which decided that case. The opinion here (R. 278) states:

> Our decision in *Munson S. S. Co.* v. *Commissioner*, *supra*, depended upon the particular statute involved; we held that the encouragement to shipbuilding, which Congress had proffered to builders, was an overriding consideration, which should be recognized, regardless of the form employed.

The same explanation of that case was given by this Court in *Moline Properties* v. *Commissioner*, 319 U. S. at 439.

North Jersey Title Ins. Co. v. *Commissioner*, 84 F. 2d 898 (C. C. A. 3d), is without authority as a precedent for it was one of the cases giving rise to the conflict in decisions, on the basis of which certiorari was granted in *Moline Properties* v. *Commissioner*, 319 U. S. 436, fn. 1. The reasons which the Court there had relied on as permitting the corporate entity to be disregarded were demonstrated to be erroneous by the *Moline Properties* decision.

with particular reference to the fact that there was no issue concerning the corporation to which the subsidiary's income was taxable and to the fact that the parties had paid their taxes on the assumption that no principal-agent relationship existed. Further, if a simple decision concerning the taxable consequences of a principal-agent relationship (a relationship which is quite frequent in the business world) were all that was contained in the opinion, there would have been no need for the court to issue precautionary statements concerning the peculiar facts involved and concerning the absence of a rule of general applicability in the decision.

Also, there is no factual basis for concluding that the subsidiary in *Southern Pacific Co.* v. *Lowe* was an agent of the parent in the technical sense of that word. The subsidiary there, by leasing its property to the parent and by merely collecting the rental from the parent, was certainly not acting on behalf of the parent as an agent would for its principal. Accordingly, when the court in the *Southern Pacific Co.* case referred (p. 337) to the subsidiary there as being the parent's "agent", it did not give that word its common legal meaning.

The factual dissimilarity between the cases is also apparent. There, the subsidiary owned the property and the source of its income was the rental payments made to it by the parent; it was the parent which utilized the property, which

conducted the business, and which created the profits. In the present case the contrary is true. The subsidiaries here own the property, they carry on the business which realizes income from outside sources, and they create the profits; the parent here, like the subsidiary in the *Southern Pacific* case, derives its income only through an affiliated corporation. As a result, the reference in the *Southern Pacific* opinion to the subsidiary as an agent (whatever may have been meant by that term) is totally inappropriate to the subsidiaries in this case.

D. THE TAX COURT DID NOT HOLD THAT THE TAXPAYERS WERE THE AGENTS OF THEIR PARENT CORPORATION

The Tax Court did not hold, as the taxpayers now contend (Br. 11–12, 14–15, 17, 18–19, 25, 28), that this was simply the case of one corporation acting as an agent for another. Indeed, as we will show (*infra*, pp. 46–50), if the Tax Court had so held there would have been no substantial support in the record for such a conclusion. The Tax Court's decisions in these cases are actually based on the assumption that the relationship between the subsidiaries and the parent justified it in disregarding the separate existence of the subsidiaries for tax purposes. That this was the thread of the Tax Court's opinion is overwhelmingly clear from the reasoning which it employed.

We refer to the following portions of the Tax Court's opinion as support for our construction of it, a construction which was concurred in by

the Court of Appeals. At the outset, after stating the contentions of the parties, the Tax Court made this initial observation (R. 29):

> It requires scant citation of authorities to establish the principle that normally corporations are separate juristic persons and are to be so treated for tax purposes. See *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S. 415, 11 AFTR 1099. Likewise mere ownership by one corporation of all of the stock of a subsidiary does not of itself merge the two corporations or create the relationship of principal and agent between them. *There are exceptions, however, particularly where the subsidiary is so much a part of the parent in its operations that it amounts to no more than a mere department or agency.* [Italics supplied.]

If the Tax Court were speaking of a simple principal-agent relationship, there would, of course, have been no reason to talk in terms of "exceptions." This is apparent for, after referring to the authorities relied on by both sides, the Tax Court said (R. 30):

> We have carefully examined the authorities cited by petitioners [taxpayers] and respondent and have studied them in the light of the facts present in the instant case and we think that the facts which we have here bring petitioners [taxpayers] within the ambit of the cases relied upon

by them rather than those relied upon by respondent.

The cases relied on by the taxpayers to which the Tax Court was there referring were: *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330; *Munson S. S. Line* v. *Commisisoner*, 77 F. 2d 849 (C. C. A. 2d); *North Jersey Title Ins. Co.* v. *Commissioner*, 84 F. 2d 898 (C. C. A. 3d). In none of those cases was there any principal-agent relationship. See Fn. 10, *supra*, pp. 37–38.

The Tax Court's reliance on *Southern Pacific Co.* v. *Lowe, supra*, also demonstrates that it did not conceive of this case as one simply involving a principal-agent relationship for it said (R. 30):

> The Supreme Court in *Southern Pac. Co.* v. *Lowe, supra*, held that the distributions which were in issue in that proceeding were not dividends for the reason that the Central Pacific and Southern Pacific were in substance identical because of the complete ownership and control which the latter possessed over the former as stockholder and in other respects. The Court said in part:
>
> > * * * While the two companies were separate legal entities, yet in fact, and for all practical purposes they were merged, the former being but a part of the latter, acting merely as its agent and subject in all things to its proper direction and control. * * *

> We think the foregoing words of the Supreme Court are aptly descriptive of the relationship which existed between petitioners and their parent, Airco, in the instant case. * * *

The Tax Court then proceeded (R. 30–32) to refer at length to the detailed circumstances of the present cases (very little of which had anything to do with the so-called agency contracts) and then concluded by saying (R. 32):

> It is true, of course, that taken separately some of the foregoing facts would not be sufficient in themselves to make inoperative the general rule that corporations are separate juristic persons and are to be so treated for tax purposes. We think, however, that when all these facts are viewed together they bring petitioners within the rule announced by the Supreme Court in *Southern Pac. Co.* v. *Lowe, supra.*

Accordingly, we believe it clear from the whole tenor of the Tax Court's opinion that it did not purport to rest its decision on any narrow grounds of principal-agent, only lately invoked by the taxpayers in an attempt to justify the Tax Court decision. As has already been demonstrated, the grounds on which the case was actually decided were erroneous; as we shall show (*infra*, pp. 44–52) the decision would have been equally wrong if the Tax Court had decided the case in the manner in which the taxpayers contend that it was decided.

Finally, before proceeding to analyze the defects of the taxpayers' "agency" argument, we wish to deny emphatically the assumption which is made throughout their brief (pp. 9, 10, 11–12, 15, 17, 18–19) to the effect that the Court of Appeals, while recognizing that the subsidiaries were agents of the parent, refused to hold that the income should be taxed to the principal. From the prior analysis of the Tax Court's opinion, it should be sufficiently clear that such a problem did not even exist. The failure of the Court of Appeals to comment on the "agency" argument may be a silent reflection on the merits of those contentions. It certainly is not a naive legal conclusion by Judge Learned Hand that a principal's income is taxable to his agent. It is true that in *Railway Express Agency v. Commissioner*, 169 F. 2d 193, 196 (C. C. A. 2d), petition for a writ of certiorari filed August 27, 1948, No. 247, this Term, the majority opinion of Judge Clark (who did not participate in the present case) referred, by way of dictum, to the subsidiaries here as agents of the parent (Pet. Br. 12, 15, 19). But that dictum clearly does not represent a studied evaluation of the present cases.

E. THE TAXPAYERS DID NOT ACT AS AGENTS FOR THEIR PARENT CORPORATION

In the light of the preceding discussion, there are fairly obvious answers to the taxpayers' principal contention, namely, that this is the simple

situation of an agent acting for a principal, with the agent collecting money which is the principal's income. Of course, since the Tax Court neither analyzed nor determined the issue in this manner, in demonstrating the fundamental defects of the taxpayers' assertions, the evidence must be reappraised to a certain extent.

The Commissioner does not at all negate the proposition that where a principal-agent relationship exists, the principal's income is taxable to him, not to the agent, even though the money may pass through the agent's hands when collected by him for transmission to his principal. Nor is it denied that, in proper circumstances, a principal-agent relationship may exist between related corporations as it may between members of a family. Of course, when a close affinity exists between taxpayers who purport to act in that capacity, a careful scrutiny of the arrangement is proper to determine whether they are actually serving in a representative capacity or whether the arrangement, in effect, is an attempt to deflect taxable income from one entity to another.

If the subsidiaries here were acting as agents for the parent, as the taxpayers contend, they ought to be able to show in what respects they acted as agents, and what was the extent of their authority as agents. It is surprising, therefore, that, making no attempt to document the conclu-

sion which they (not the Tax Court) draw, the taxpayers should be content to say (Br. 14):

> The record is full of evidence establishing the principal-agent relationship. This Court need not review that evidence. It is fully reflected in the findings of the Tax Court charged with the determination of fact matters in tax cases.

Actually, the undisputed facts do not in any way justify the conclusion that the subsidiaries were acting as simple agents for the parent and that they were merely collecting money which was income pertaining to the parent. The contract between the parent corporation and the taxpayer, Air Reduction Sales Company (set out in full at pp. 6–8, *supra*), for example, states in part that (R. 13):

> First.—Airco hereby employs Sales as its agent to manage and operate, during the term of this contract, all plants for the production of oxygen, acetylene and other gases and for the manufacture of apparatus and containers for the utilization and transportation of such gases, which it or its subsidiary or controlled companies now own or control, or which it or they may hereafter build or acquire; and likewise employs Sales as its agent to market and sell, during the term of this contract, the output of all such plants.

These recitations of the contract, at first blush, would give the impression that the subsidiary was

merely employed as an agent to operate facilities belonging to the parent. The undisputed facts, however, are conclusively to the contrary. See pp. 16–30, *supra*. As we have seen, the subsidiaries owned all the manufacturing plants and facilities used in their respective businesses (with the exception of the gas cylinders previously referred to) so that they could not possibly have been acting as agents for the parent in the manner described by the contract.

Furthermore, if the subsidiaries were acting as agents so that the profits of the business were truly those of the parent, as principal, it would have to follow that the losses would also be those of the parent. Yet the contract, while requiring the subsidiaries to incur all expenses, nowhere states that they do so as agents of the parent or requires the parent to reimburse the subsidiary to the extent that expenses exceed income.

Even under common law concepts, it is essential to the creation of the principal-agent relationship that the agent be empowered to "bind" his principal in some respects. In the words of the *Restatement of the Law of Agency*, Sec. 12:

> An agent or apparent agent holds a power to alter the legal relations between the principal and third persons and between the principal and himself."[11]

[11] Comment (a) to this section states, in part:

> The exercise of this power may result in binding the

The subsidiaries possessed no authority to alter legal relations between the parent and anyone else. They certainly did not in the operation of the plant and machinery which they themselves owned. They certainly did not when they purchased supplies and equipment, for it is undisputed that the subsidiaries acquired title to such assets. They certainly did not when they sold their own products to the public. These matters being true and undisputed, it is impossible to conclude that they held the profits from those sales as an agent would when he sells property belonging to his principal.

The mere recitation of an agency relationship does not establish one. Where, as here, the undisputed facts show that the corporation is using its own property in the conduct of the corporate business, it cannot, as a matter of law, be regarded as using its property as an "agent" for the stockholder. In *Burnet* v. *Commonwealth Imp. Co.*, 287 U. S. 415, the Court refused to relieve the corporation from tax on gains attributable to the sale of its property to its sole stockholder; to the argument that the corporation was

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principal to a third person in contract; in divesting the principal of his interests in a thing, as where the agent sells the principal's goods; in the acquisition of new interests for the principal, as where the agent buys goods for the principal; or in subjecting the principal to a tort liability, as where a servant, while acting within the scope of his employment, injures a third person. * * *

merely an agency or instrumentality of the single stockholder, the Court replied (p. 420):

> The situation is not materially different from the not infrequent one where a corporation is controlled by a single stockholder.

Again, in *Moline Properties* v. *Commissioner*, 319 U. S. 436, where the corporation also attempted to be relieved from tax on gains resulting from the sale of corporate property, and where the argument was also advanced that the corporation was an agent for its sole stockholder, the Court said (pp. 440–441):

> There was no actual contract of agency, nor the usual incidents of an agency relationship. Surely the mere fact of the existence of a corporation with one or several stockholders, regardless of the corporation's business activities, does not make the corporation the agent of its stockholders. Therefore the question of agency or not depends upon the same legal issues as does the question of identity previously discussed. * * *

The present cases, too, do not present the usual incidents of an agency relationshp. The situation here differs from the *Commonwealth Imp. Co.*, *Moline Properties*, and *Joliet & Chicago R. Co.* cases only in that here the parties have gone through the motions of calling each other "principal" and "agent." We submit, however,

that if, in the *Commonwealth Imp. Co.* and *Moline Properties* cases, the corporations had purported to sell their corporate properties as "agents" for their stockholders, or if in the *Joliet & Chicago R. Co.* case the corporation had purported to lease its property as "agent" for its stockholders, the tax results would have remained the same. The concept of the derivative rights of the stockholders with respect to the property and profits belonging to the corporation are too fundamentally rooted in the taxing statute to permit the tax results to be altered by the simple expedient of adopting nomenclatures which do not aptly describe the true legal relationships among the parties.

We believe that much significance is to be attached to legislative action with respect to the manner in which affiliated corporations can compute their tax liabilities. When Congress desired or permitted such corporations to be taxed as a group, it knew how to do so. Thus, during the period from 1918–1933, Congress permitted the consolidation of earnings or losses of related corporations by provisions allowing the filing of consolidated returns.[12] However, it is of the greatest importance that the privilege of filing

[12] Section 240, Revenue Act of 1918, c. 18, 40 Stat. 1057; Sections 240 and 1331, Revenue Act of 1921, c. 136, 42 Stat. 227; Section 240, Revenue Acts of 1924, c. 234, 43 Stat. 253, and of 1926, c. 27, 44 Stat. 9; Section 142, Revenue Act of 1928, c. 852, 45 Stat. 791, and Section 141, Revenue Act of 1932, c. 209, 47 Stat. 9.

such returns, except for a limited class of corporations, was withdrawn by the Revenue Act of 1934[13] and was not available during the taxable year involved here. Also, while the privilege of filing consolidated returns was subsequently extended, Congress provided for an addition to the tax rate and a more limited exemption where the privilege is exercised.[14] It is submitted that affiliated corporations cannot, by the simple expedient of utilizing convenient contracts, create for themselves the authority of consolidating their corporate incomes when Congress has not seen fit to extend to them the privilege of filing consolidated returns.

If an agreement of the nature involved here (whether called an agency agreement or anything else) were to have the effect of shifting tax liabilities from the corporation, the net result would be to permit the corporate entity to be disregarded, for tax purposes, at the will of the stockholder. If the stockholder can at once have all the advantages that flow from utilizing the corporate form and, at the same time, for tax purposes, claim that the corporation is his agent and

[13] Section 141, Revenue Acts of 1934, c. 277, 48 Stat. 680, of 1936, c. 690, 49 Stat. 1648, of 1938, c. 289, 52 Stat. 447, and of the Internal Revenue Code.

[14] See Section 141 of the Internal Revenue Code, as amended by Section 159 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, Sections 131 and 204 (c) of the Revenue Act of 1943, c. 63, 58 Stat. 21; and Section 2 (c) of the Tax Adjustment Act of 1945, c. 340, 59 Stat. 517.

that its earnings (save only those that he permits it to retain) are taxable only to him, then the legislative purpose of taxing the corporation as a separate entity and of taxing the stockholder on the derivative income which he receives, is reduced to naught. The Court undoubtedly had this in mind in the *Moline Properties* case, *supra*, when it observed (319 U. S. at 440–441) "the question of agency or not depends upon the same legal issues as does the question of identity previously discussed."

F. THE TAXPAYER CORPORATIONS, BY AGREEING TO PAY THEIR PROFITS TO THEIR PARENT STOCKHOLDER, DID NOT INCUR DEDUCTIBLE BUSINESS EXPENSES

The taxpayers advance what purports to be an alternative argument (Br. 21–24), namely, that the taxpayers should be permitted to deduct as ordinary and necessary business expenses under Section 23 (a) (1), Revenue Act of 1938, Appendix, *infra*, pp. 61–62, their profits which they had agreed to pay to the parent stockholder. When examined for substance, this argument will be found to be only another way of attempting to have a corporation's entity disregarded and the true relationship between it and its stockholders ignored.

At the outset, it should be clear that there is no question concerning the deduction by the taxpayers of the normal business expenses which were

actually incurred by them in the conduct of their respective businesses. Such direct expenditures as were incurred by the taxpayers were allowed as deductions by the Commissioner (R. 9–12, 36–42). Indeed, in order "clearly to reflect the income" of the taxpayers, the Commissioner added to the amounts deductible by the taxpayers approximately $400,000 of expenditures which were incurred directly by the parent. (R. 6–7, 40.) In doing so, the Commissioner acted under Section 45 of the Revenue Act of 1938, Appendix, *infra*, p. 62.

What the taxpayers are now asking to have allowed as a business deduction consists, not of the expenses incurred in earning their profits, but of the very profits themselves. They seek to do so on the ground that they have agreed to pay those profits to their stockholder because the stockholder supplied them with their capital.

We submit that when Congress imposed an income tax on corporations, it was never intended that a corporation should be able to insulate its profits against the operation of the statute by agreeing that the corporate profits should belong to the stockholder in consideration of his having enabled the corporation to acquire and own its assets. Since the relationship between the stockholder and the corporation presupposes that the stockholder's investment in the corporation will

enable the corporation to acquire its assets, and since the stockholder will become entitled to share in the corporation's profits and property only as they may come to him in the form of dividends or on dissolution, it is manifest that an agreement by the corporation to pay its profits directly to the stockholder will not relieve the corporation from tax. See *United States* v. *Joliet and Chicago R. Co.*, 315 U. S. 44, and the discussion, pp. 25–30, *supra*. Cf. *Raybestos-Manhattan Co.* v. *United States*, 296 U. S. 60. We believe that this is inherent in the statute.

We contend further, as a matter of law, that where a corporation does enter into such an agreement, it does not incur an expense deductible under the express terms of Section 23 (a) (1). In view of what has been said, it is clear that it is neither an "ordinary" nor a "necessary" expense for a corporation to agree to pay over its profits to its stockholder.[15]

The parent stockholder here, for reasons satisfactory to it, saw fit not to engage in the business of manufacturing and selling products directly.

[15] The taxpayers' reliance (Br. 22–23) on *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, is greatly misplaced. That case held that the parent stockholder could not deduct as a business expense amounts paid to the subsidiary to make up an operating deficit. Even though the stockholder might, in other circumstances, be entitled to a similar deduction, it would not at all follow that the converse would be true, namely, that the corporation would be entitled to a deduction on account of profits which it has agreed to pay over to its stockholder.

It elected, instead, to have that done by separate corporations. The stockholder cannot enjoy those benefits without accepting the tax incidents which Congress has imposed by taxing the corporate income to the corporation. Nor can it alter those incidents by any arrangement which seeks to impute the corporate income to the stockholder, as a principal, when a true principal-agent relationship is lacking, or which seeks to permit the corporation to distort its income by deducting payments which it makes to its stockholder out of profits.

Finally, we desire to urge that if this be a true alternative contention, the taxpayers are improperly seeking to raise a new issue on appeal. The Commissioner's deficiency determinations were based only on the theory that the income of each taxpayer was attributable to it, as a separate corporation. (R. 40.) The taxpayers' petitions before the Tax Court (R. 36–42) controverted this only in respect to the question whether the income belonged to them or to the parent. There was no suggestion that some or all of the disputed income was, alternatively, deductible as a business expense. The rather extensive opening statement (R. 44–60) made on behalf of the taxpayers is devoid of any contention that such a question of deduction was in issue. Throughout the lengthy development of the facts in the trial of the case, there was no suggestion that a deduction under

Section 23 (a) (1) was involved. Nor was any such contention made in the taxpayers' brief before the Tax Court. Indeed, long prior to the conclusion of the testimony, pursuant to a question asked by the Tax Court Judge, counsel for both sides agreed that there was no issue concerning the amount of the expenses which the Commissioner in his deficiency notice declared to be deductible by the taxpayers. (R. 183.) This led the Tax Court to say in its opinion (R. 34):[16]

> Petitioners [taxpayers] make no contention that if they lose on this issue they are in the alternative entitled to deduct as business expenses the amounts of income which they turned over to Airco. They concede that if the issue which is raised by the pleadings is decided against them, then the deficiencies are those which have been determined by respondent [the Commissioner]. On the other hand, respondent concedes that if the issue raised by the pleadings is decided in favor of the petitioners, then there are no deficiencies.

The taxpayers, in their brief and on oral argument before the Court of Appeals made no con-

[16] While the taxpayers contend (Br. 24) that the Tax Court misunderstood counsel, this is a decided after-thought for, until now, the accuracy of the above-quoted portion of the Tax Court's opinion has never been challenged. Actually, a fair reading of the exchange between counsel and the Tax Court Judge affirms the Tax Court's understanding of the matter—a conclusion which would have been clear from the pleadings even in the absence of this concession.

tention respecting the deductibility of these amounts as a business expense.

It was not until the taxpayers' petition for rehearing in the Court of Appeals (R. 284–287) that there was any attempt to raise an issue concerning the deductibility of the payments which the taxpayers agreed to make to their stockholder.

If there were any substance to this contention, it would plainly come too late at this stage of the proceedings after the factual record had been completed. Whether expenses are "ordinary" and "necessary," whether they were "paid" and even whether they were "incurred in carrying on" a trade or business raise, in some respects, questions of simple fact. *Commissioner* v. *Heininger*, 320 U. S. 467, 475. The taxpayers cannot interject such issues now. *Bankers Coal Co.* v. *Burnet*, 287 U. S. 308; *General Utilities Co.* v *Helvering*, 296 U. S. 200.

II

THE COURT OF APPEALS POSSESSED AUTHORITY TO REVERSE ERRONEOUS DECISIONS OF THE TAX COURT

There remains the question whether the court below exceeded its powers of review when it sustained the Commissioner's deficiency determinations and reversed the Tax Court for having failed to do so. If we are correct in our view

that the Tax Court decided the cases by the application of erroneous legal principles, the Court of Appeals possessed full authority to correct decisions which were not in accordance with law. Section 1141 (c) of the Internal Revenue Code, which was applicable when the cases were decided by the Court of Appeals, expressly provides that the reviewing court may reverse such a decision, a matter which was affirmed by *Dobson* v. *Commissioner*, 320 U. S. 489, 492–493, rehearing denied, 321 U. S. 231, and by cases in which Tax Court decisions have been overturned. See *McWilliams* v. *Commissioner*, 331 U. S. 694; *Crane* v. *Commissioner*, 331 U. S. 1; *Commissioner* v. *Wilcox*, 327 U. S. 404; *Commissioner* v. *Estate of Holmes*, 326 U. S. 480; *Trust of Bingham* v. *Commissioner*, 325 U. S. 365, and cases cited p. 371, fn. 1.[17]

In this connection, the taxpayers' contention that the Court of Appeals had no authority to reverse the Tax Court (Br. 25–28) is colored by the erroneous assumption made here and elsewhere in their brief, namely, that the Tax Court

[17] Section 1141 (a) of the Internal Revenue Code was amended by Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess., so as to make the decisions of the Tax Court subject to review by the Courts of Appeals "* * * in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury * * *." Section 38 of that Act provides that its provisions should take effect on September 1, 1948.

was merely deciding a simple fact question whether a principal-agent relationship existed. As we have already shown, pp. 40–44, *infra*, such was not the nature of its decision.

Moreover, even if the cases could be regarded as instances of those in which the Tax Court makes evidentiary determinations, it does not at all follow that its conclusions are immune from reexamination by the reviewing courts. Unless there is some rational basis in the record to support those conclusions, the Tax Court's decision is erroneous and subject to reversal no less than where it has applied erroneous legal principles. Here, if the existence of a principal-agent relationship sufficient to make the parent the taxable earner of the income be stressed, or if the broader scope of the entire record be analyzed, we submit that there is no rational foundation to support the Tax Court's decisions. See pp. 15–30, 44–52, *supra*.

Accordingly, the Tax Court's ultimate conclusion that the parent, rather than the subsidiaries, is the taxable owner of the income is no less erroneous and no less required to be reversed than was its decision that the embezzler was the taxable owner of the income in *Commissioner* v. *Wilcox*, 327 U. S. 404. The Court of Appeals was altogether correct in reversing the erroneous decisions of the Tax Court.

CONCLUSION

The decisions of the Court of Appeals should be affirmed.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
STANLEY M. SILVERBERG,
ELLIS N. SLACK,
LEE A. JACKSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

DECEMBER 1948.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

* * * * * *

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000 * * *.

* * * * * *

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for

salaries or other compensation for personal services actually rendered; * * *

* * * * *

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses.

SEC. 602. EXCESS-PROFITS TAX.

(a) If any corporation is taxable under section 601 with respect to any year ending June 30, there is hereby imposed upon its net income for the income-tax taxable year ending after the close of such year, an excess-profits tax equal to the sum of the following:

6 per centum of such portion of its net income for such income-tax taxable year as is in excess of 10 per centum and not in excess of 15 per centum of the adjusted declared value;

12 percentum of such portion of its net income for such income-tax taxable year as is in excess of 15 per centum of the adjusted declared value.

T. D. 4829, 1938–2 Cum. Bull. 98:

* * * * *

EXCESS-PROFITS TAX

REGULATIONS RELATING TO THE EXCESS-PROFITS TAX IMPOSED BY SECTION 602 OF THE REVENUE ACT OF 1938

* * * * *

ART. 2. *Scope of tax.*—The excess-profits tax, imposed by section 602 of the Revenue Act of 1938, is imposed upon the net income of every corporation for each income-tax taxable year ending after the close of any year ending June 30 in respect of which the corporation is subject to the capital stock tax imposed by section 601 of that Act.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 13–1. *Tax on corporations in general.*—Section 13 imposes an income tax on corporations in general the net income of which is more than $25,000.

* * * * *

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

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